AN EVALUATION OF PROPOSALS TO EXTEND AND AMEND THE RENEGOTIATION ACT OF 1951

A REPORT BY THE STAFF OF JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

SUBMITTED TO THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

AND THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

PURSUANT TO

SECTION 11 OF

PUBLIC LAW 93–368

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LETTER OF TRANSMITTAL

CONGRESS OF THE UNITED STATES,
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION,
Washington, D.C., September 30, 1975.

Hon. AL ULLMAN,
Chairman, Committee on Ways and Means,
House of Representatives, Washington, D.C.
Hon. RUSSELL B. LONG,
Chairman, Committee on Finance,
U.S. Senate, Washington, D.C.

DEAR CHAIRMEN ULLMAN AND LONG: Pursuant to section 11 of Public Law 93–368, the staff of the Joint Committee on Internal Revenue Taxation is transmitting its report and recommendations on the renegotiation process to the House Committee on Ways and Means and the Senate Committee on Finance.

The staff report is divided into three parts: (1) "Summary of Staff Recommendations on the Renegotiation Process"; (2) "Background on the Renegotiation Process and Operations of the Board," and (3) "Analysis of Present Law and Proposals to Amend the Renegotiation Act of 1951." Part I of the report was submitted previously to you on September 10, 1975. Part II presents a discussion of the renegotiation process, a brief history of the Renegotiation Act, and data on the operations of the Renegotiations Board for the fiscal years 1968–1975. Part III is the main segment of the report, as it presents a discussion of present law and an analysis of proposals for change in 21 areas affecting renegotiation (and includes the staff recommendations and reasons in each of these areas).

As indicated in the introduction, the staff has made use of various sources of information: previous reports by the Joint Committee staff; hearings and reports of other congressional committees (including the Committee on Ways and Means, the Committee on Finance, the Joint Economic Committee, the House Committee on Government Operations and the House Subcommittee on General Oversight and Renegotiation); reports by the General Accounting Office, the Cost Accounting Standards Board and the Commission on Government Procurement; and studies and reports by the staff of the Renegotiation Board. In addition, the staff received comments from industry representatives and the legal, accounting and economic professions (through both written statements and staff conferences).

Respectfully submitted.

LAURENCE N. WOODWORTH,
Chief of staff.

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INTRODUCTION

Basis for Staff Study

At the time of the last extension of the Renegotiation Act in 1974, both the House Ways and Means and Senate Finance Committee Reports requested that the Joint Committee staff continue its previously begun study on the renegotiation process and report to the committees in sufficient time prior to the expiration of the Act (December 31, 1975), as extended by Public Law 93–329.

Subsequent to that 18-month extension of the Renegotiation Act (June 30, 1974 to December 31, 1975), an amendment by Senator Proxmire to H.R. 8217 directed the Joint Committee staff to conduct a study of the Renegotiation Act to determine whether the Act should be extended (P.L. 93–368). If the Act were to be extended, the staff was further instructed to see how the administration of the Act could be improved, to consider whether the exemption criteria and statutory factors for determining excessive profits should be changed to make the Act "fairer and more effective and objective," and also whether the Board should be restructured. In conducting the study, the Joint Committee staff was directed to consult with the staffs of the General Accounting Office, the Cost Accounting Standards Board, the Joint Economic Committee, and the Renegotiation Board. Finally, the Joint Committee staff was instructed to submit a report to the House Ways and Means and Senate Finance Committees on or before September 30, 1975.

Part I ("Summary of Staff Recommendations on the Renegotiation Process") of the report was submitted previously on September 10, 1975, so that the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing (which now has jurisdiction over renegotiation in the House) would have the Joint Committee staff recommendations available for its consideration during the drafting of its legislative proposals for extending and amending the Renegotiation Act of 1951.

Procedure for Staff Study

During the course of its study on renegotiation, the staff of the Joint Committee conducted interviews with the staff (and members) of the Renegotiation Board. In addition to the Board members (and their special assistants), the Joint Committee staff discussed the vari-

ous phases of the renegotiation process with the pertinent Board staffs—from the headquarters staff to the Regional Board members and staffs (Eastern and Western Regional Boards). At the headquarters office, this included staff in the General Counsel's Office, Office of Planning and Analysis, Office of Accounting, Office of Review, Office of Administration and the Office of the Secretary. In the two regional offices, discussions were held with the respective board members and staff in the divisions of accounting, renegotiation and procurement.

Also, the Joint Committee staff reviewed selected Board case files from recent years, including exemption files, clearance cases, agreement cases and unilateral order cases. This included reviewing a number of final Board memoranda of decision and final opinions in excessive profits determinations. The Board and its staff have been very cooperative in supplying various studies, reports and other information requested by the Joint Committee staff. This information has been very helpful in making this report.

In its review of proposals on renegotiation, the Joint Committee staff also has consulted (as directed by Public Law 93–368) with the staffs of the General Accounting Office (Procurement and Systems Acquisition Division), the Cost Accounting Standards Board and the Joint Economic Committee. In addition, the Joint Committee staff received numerous written statements in response to its June 11, 1975, Press Release (see Appendix A), which invited comments on 21 topics from industry representatives or any other persons or organizations interested in the operations of the Renegotiation Board. Comments were received from several industry associations, business firms, attorneys, accountants, economists, renegotiation consultants, and a former Chairman of the Renegotiation Board. The Joint Committee staff also had conferences with several of the groups and individuals submitting written statements.

In addition to the above-mentioned consultations, interviews, conferences and written comments, the Joint Committee staff made use of various other sources of information relating to renegotiation; the legislative history of renegotiation; previous and current congressional hearings and reports (including earlier reports by the Joint Committee on Internal Revenue Taxation and those of the House Committee on Ways and Means, the Senate Committee on Finance, the Joint Economic Committee, the House Committee on Government Operations, House and Senate Appropriations Committees, and the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing); and reports by the General Accounting Office, the Cost Accounting Standards Board and the Commission on Government Procurement.

PART I:

SUMMARY OF STAFF RECOMMENDATIONS ON THE RENEGOTIATION PROCESS

1. Extension of the Renegotiation Act

The staff believes that the Renegotiation Act should be extended for a period of at least 5 years, rather than being made permanent at this time because of the need for further congressional review as to how the Board adapts to the recommended changes in the Act and in Board organization and operation. The staff considers a shorter extension of 2 or 3 years to be too short for proper Board planning and personnel recruitment, as well as being too short a time for an evaluation of the Board's progress in responding to the recommended changes. Since a 5-year extension would place the expiration date at the end of 1980, and since 1980 is an election year, the staff recommends that the Renegotiation Act of 1951 be extended for a period of 6 years, or through December 31, 1981.

2. Agencies Covered by the Renegotiation Act

While arguments can be made for the extension of renegotiation coverage to other agencies, the staff believes that the Renegotiation Board should at this time concentrate on improving its review of Government contracts under existing agency coverage. The staff therefore recommends retaining existing law coverage at the present time, but that this be reconsidered after the Board has time to adapt to proposed changes and has had an opportunity to operate under them for a period of time. In addition, since the Atomic Energy Commission has been reorganized and divided between the Nuclear Regulatory Commission and the Energy Research and Development Administration, the staff suggests that the statute be amended to reflect the reorganization by specifically listing the two new successor agencies.

3. Statutory Factors

Based upon conclusions that the existing statutory factors are generally appropriate for consideration by the Board in determining whether a contractor had realized excessive profits, and that the principal problem under present law concerns the application of the existing factors in the renegotiation process, the staff recommends that—

(1) The Board be directed to issue written guidelines describing in detail the principles which will be employed in applying the statutory factors. Before final adoption and implementation, however, the Board's proposed guidelines should be submitted to Congress not later than June 30, 1976, in order to permit consideration of the need for further legislation prior to their adoption. Further, the Board should be directed to include guidelines in further elaboration of the manner in which the special problems of small business will be taken

into account and the manner and extent to which an agency's negotiating policies, including the "weighted guidelines" used for pricing purposes will be taken into account.

(2) The "reasonableness of costs and profits" factor be amended to provide that, in determining excessive profits for a fiscal year, the profitability of the preceding three fiscal years and the next succeeding fiscal year be considered by the Board.

(Under present law, the Board considers "deficient" profits for prior fiscal years in a limited number of situations. This modification of the statutory factor would enable the Board to alleviate inequities which arise from fiscal year renegotiation in a wider range of situations.)

(3) The so-called "net worth" factor under section 103(e)(2) of the Act be revised by striking out "net worth" and referring only to "capital employed."

(4) A technical language change is recommended to change the phrase "war and peacetime products" to "renegotiable and non-renegotiable products and services."

4. Accounting Standards

(1) The staff recommends that the general application of tax accounting standards be continued at the present time for the purpose of determining the "allowability" of costs and expenses.

This recommendation is based primarily upon practical and administrative considerations. The staff is aware that tax accounting standards may not be entirely satisfactory for renegotiation purposes. However, in light of the body of tax law and rules and regulations which have developed, the application of the tax accounting standards will generally provide more definitive rules and result in more uniform treatment of contractors than would be the case with the application of general accounting principles or under the Armed Services Procurement Regulations (ASPR). Moreover, it is noted that the principal focus of the ASPR rules is related to pricing on a contract-by-contract basis rather than to the aggregate fiscal year profits of a contractor. In addition, continuation of the tax accounting standards would provide some audit backup by a Government agency (the IRS) which would not otherwise be available. Moreover, the Board will continue to have authority (as under present law) to consider the effect of tax accounting under the "reasonableness of costs" statutory factor and to prescribe rules relating to the "allocation" of costs to renegotiable business, without regard to the question of "allowability" for tax accounting purposes.

(2) The staff also recommends that the Board be given the authority to prescribe regulations for selective exemption from the application of specific rules prescribed by the Cost Accounting Standards Board whenever the Renegotiation Board determines that a conflict exists between application of tax accounting standards and a cost accounting standard.

5. Exemptions

The staff recommends that the following exemptions be repealed:

(1) Standard commercial articles and services;

(2) Competitively-bid construction contracts; and

(3) New durable productive equipment.

If the exemption for standard commercial articles and services is not repealed, the staff suggests that the exemption be tightened by removing the "class" exemption and the "waiver of exemption" provision, and by raising the percentage test from 55 percent to 70 or 75 percent. Also, it is suggested that the percentage test be modified to exclude sales to noncovered Government agencies as qualifying for the minimum percentage.

In addition, the staff recommends that the Board be directed to evaluate the raw materials exemptions and the related question of the "cost allowance" provision for integrated firms, and to report directly to the Congress not later than June 30, 1976.

6. Classification of Contractor Sales

The staff recommends that—

(1) The Act be amended to codify the Board's position that it has the authority to analyze renegotiable business by product line, profit center, segment or division, but that, generally, the final determination of excessive profits be made on an overall fiscal year basis by aggregating such product lines, profit centers, segments or divisions.

(2) As an exception to the general rule for aggregation for a fiscal year, the Board be given discretionary authority to make a final excessive profit determination on a product line, profit center, segmental or divisional basis where there are clear reasons for making such a determination—for example, where renegotiation on an aggregate fiscal year basis would result in allowing an offset against excessive profits for losses or below normal profits arising from an acquisition of another business, or adoption of a pricing policy, with the objective of eliminating competition and thereby becoming the sole source supplier of a product or service.

7. "Floor" Levels

The staff recommends that the $1,000,000 general floor not be changed at the present time; however, the staff does recommend that the $25,000 floor for brokers and agents be raised to $50,000.

8. Minimum Refund Level

The staff recommends that the Renegotiation Board be directed not to set any specified minimum refund level (an amount below which excessive profits determinations will not be pursued). Under the Board's present regulations, determinations of excessive profits below $80,000 ($20,000 for brokers and agents) are not pursued by the Renegotiation Board although this practice is not specifically authorized by statute. The staff has concluded that there are no justifiable reasons for setting a particular minimum level of excessive profits that will not be pursued. If the Board determines such levels are "excessive," then the contractor should not be allowed to avoid payment.

9. Board Structure

The staff believes that the Board should remain as an independent agency within the Executive Branch; nevertheless, during the 6-year extension period, it is recommended that the Board be required to (1) submit any budget or other legislative proposals to Congress at the time of submission to the Office of Management and Budget, and (2) make detailed, periodic reports to Congress on operations and changes

in organization and procedure in addition to the largely statistical annual reports the Board now makes to Congress.

10. Board Organization and Membership

The staff recommends:

(1) 5-year staggered terms for Board members;

(2) providing that when a member's term has expired, the member is to continue to serve until a new member (or the reappointed member) is ready to assume office, but in no event longer than 6 months;

(3) providing that the President is to designate a member of the Board to serve as Chairman;

(4) limiting the number of Board members of one political party affiliation to three;

(5) providing statutory administrative powers for the Chairman; and

(6) raising the salary of the Chairman to one level above that of the other Board members.

11. Board Staffing and Budget

The staff believes that there is a need to increase the Board's staff in order to reduce the case backlog and to expedite the handling of cases assigned: more specifically, the staff recommends an increase in the Board's research and planning staff to work on guidelines for the statutory factors and other staff research matters; additional personnel in the screening process to provide a more thorough review of filings for possible assignment to regional offices for further analysis; strengthening the economic analysis capability (headquarters and regional offices) to assist in providing more concrete economic analysis in Board opinions and in developing industry economic analysis; and additional legal staff to allow the General Counsel's office to follow more closely cases referred to the Department of Justice as well as cases tried in the Court of Claims.

12. Board Field Organization

While it is probable that the Board needs more regional personnel (and possibly additional offices), the Board needs to have additional time to adapt to any legislative changes and to evaluate the resulting impact on procedures and workload. In view of the staff's recommendation for the Board to review the possible application of the Administrative Procedures Act (No. 16, below), the staff suggests that such a review include the possible impact on the regional board procedures and organization. The staff further suggests that the Board be directed to report directly to Congress not later than June 30, 1976, on the need for additional regional offices to adequately and expeditiously process cases.

13. Penalties for Late Filing

The staff recommends that civil penalties of $100 per day be set for late filing of required financial statements (up to a maximum of $100,000) for any given year's return, and that similar penalties be provided for failure to provide requested data and information. However, it is further recommended there be procedures for an abatement of a penalty for reasonable cause and for appealing such a penalty in court.

14. Subpoena Power

The staff recommends that the Board be given subpoena power for books and records, with enforcement through a Federal District Court where the contractor for any reason fails to obey the subpoena. Further, the staff recommends that only a majority of either the statutory Board, a "division" of the Board, or of a regional board be authorized to issue a subpoena.

15. Interest Charged on Redeterminations

The staff recommends that on excessive profit determinations, the interest charge commence 30 days after a regional board has issued either a final opinion or has notified the contractor of its recommendation of an excessive profit determination. In addition, it is recommended that interest should be charged for previous periods where the contractor has delayed renegotiation because of failure to file returns or submit requested information on a timely basis.

16. Contractor Appeals Procedure

The staff recommends that no change be made at the present time with respect to the contractor appeals procedure. However, the staff further recommends that the Board be directed to evaluate the effect of applying the Administrative Procedure Act to the Board (including possible application to regional boards), and to report its findings and recommendations directly to the Congress not later than June 30, 1976.

The staff is aware that application of the Administrative Procedure Act would beneficially affect certain aspects of renegotiation and adversely affect other aspects. The beneficial effects would include providing due process for contractors, requiring the development of case records, promoting the issuance of better decisions, and alleviating the costliness of litigation if the Court of Claims review were in the nature of an appellate review rather than a *de novo* trial. The adverse effects would include aggravating the case backlog problem (since development of the case record would be more time consuming) and increasing the costs of proceedings before the Board. In view of these considerations, the staff believes that the Board should be given an opportunity to study the impact of applying the Administrative Procedure Act to its proceedings, and to report its findings to the Congress.

17. Court Jurisdiction

The staff believes that the Court of Claims should retain jurisdiction over renegotiation cases.

(Part II of the staff's report will include an analysis of the reasons for the differences in settlement levels since the jurisdiction was changed from the Tax Court to the Court of Claims.)

18. Bonding Requirement

Attorneys active in renegotiation proceedings have recommended eliminating or modifying the requirement that a bond be posted by any plaintiff appealing a determination of excessive profits to the Court of Claims. They argue that this may prevent a contractor in financial difficulty from obtaining a court hearing because a bond posted directly with the court must be in the full net amount of the

determination (the amount of the determination less the estimated Federal tax credit that would result from refund of the profits in question), while a bond obtained from a surety company must normally be fully collateralized in the amount of the determination.

However, the staff has been informed by the Justice Department that it presently has a procedure of entering a judgment for the bond amount and then working out a payment schedule with the contractor, which allows the contractor to go to court while he is making payments on the judgment for the bond. Therefore, the staff concludes that no statutory change is necessary to give the contractor his day in court. Moreover, the viable alternatives to the present procedure (such as placing a lien on the contractor's property) would offer little, if any, added relief to the contractor than is now available under present procedures.

19. Carryback of Losses

The staff recommends that loss carrybacks not be allowed (but see item No. 3, above).

20. Averaging of Profits

The staff does not recommend the adoption of a specific formula for the averaging of profits. (However, as indicated above, the staff recommends an amendment to the "reasonableness of costs and profits" statutory factor to provide for consideration of the profitability of certain fiscal years preceding and succeeding the fiscal year under review.)

21. Annual GAO Report on Renegotiation

The staff believes that there is no need to require the GAO to review and report on renegotiation on an annual basis, since the GAO will make whatever reviews and reports the Congress requests from time to time.

PART II:

BACKGROUND ON THE RENEGOTIATION PROCESS AND OPERATIONS OF THE RENEGOTIATION BOARD

A. OUTLINE OF THE RENEGOTIATION PROCESS

Renegotiation is a process whereby the Government, acting through an independent establishment in the executive branch known as the Renegotiation Board, may require a contractor to refund that portion of profits on Government contracts or related subcontracts which are determined to be "excessive." In making this determination, the Board reviews and analyzes amounts received or accrued by a contractor during his fiscal year (or such other period as may be fixed by mutual agreement) on contracts, and on related subcontracts, with the Government Departments named in the Renegotiation Act of 1951, as amended. Amounts received under such renegotiable contracts and subcontracts are variously referred to as "renegotiable sales," "renegotiable business," and "renegotiable receipts or accruals." The Departments named in the Act are the Department of Defense, the Departments of the Army, Navy and Air Force, the Maritime Administration, the Federal Maritime Board (reorganized in 1961 into the Maritime Subsidy Board and the Federal Maritime Commission), the General Services Administration, the National Aeronautics and Space Administration, the Federal Aviation Agency (now, Administration), and the Atomic Energy Commission (which was reorganized in 1974 by Congress into the Nuclear Regulatory Commission and the Energy Research and Development Administration).

Under the Renegotiation Act of 1951, as amended, the Renegotiation Board is composed of five members appointed by the President, by and with the advice and consent of the Senate. Under the Act, the Secretaries of the Army, Navy, and the Air Force, respectively, subject to the approval of the Secretary of Defense, and the Administrator of the General Services Administration, are each to recommend to the President, for his consideration, one person from civilian life to serve as a member of the Board. The President designates one member to serve as Chairman. (There is no specific term of appointment for the Board members.) No member is permitted to actively engage in any business, vocation, or employments, other than as a member of the Board. The principal office of the Board (frequently referred to as the headquarters office) is required by the Act to be in Washington, D.C. Under authority granted to it by the Act, the Board now has two regional boards, located in Washington, D.C. and Los Angeles, California.

The Act does not apply to amounts received or accrued under contracts or subcontracts exempt under section 106 (providing for "mandatory" and "permissive" exemptions), or to those amounts which are

below the minimum amount specified in section 105(f). This minimum amount for contractors presently is $1,000,000 of "renegotiable sales" (except it is $25,000 for brokers and agents), and it is commonly referred to as the "floor." Under the Act, renegotiation is conducted with respect to all amounts received or accrued by a contractor or subcontractor during his fiscal year (or such other period as the Board and the contractor may agree upon) under contracts (and related subcontracts) with all Government Departments specified in the Act. Under this procedure, it is said that renegotiation is on a "fiscal-year" basis, rather than a contract-by-contract basis.

In order for the Renegotiation Board to determine "excessive profits," it is first necessary that the contractor or group of contractors to be renegotiated be identified, that the accounting period and method of accounting to be used for renegotiation be fixed, and that sales, costs and profits be determined and segregated as between renegotiable and nonrenegotiable business. Then, a determination may be made of the amount, if any, of renegotiable profits which constitute "excessive profits," which requires the application of the so-called "statutory factors" set forth in section 103(e) of the Act.

The renegotiation procedures provided for by the Act require that there be a proceeding before the Board in which a contractor is either determined not to have excessive profits (a so-called clearance) or is determined to have excessive profits; such a determination of excessive profits is made either by agreement between the contractor and the Board, or by a unilateral order of the Board. (The Board has delegated authority to the regional boards to make a clearance or to enter into an agreement with the contractor for a determination in "Class B" cases—involving renegotiable profits of $800,000 or less.) Section 111 of the Act excludes the functions of the Board from the operation of the Administrative Procedure Act except as to the public information requirements of section 3 thereof. Section 3 of the Administrative Procedure Act was amended by Public Law 90–23 in 1967, and the Board has revised its regulations (part 1480) to provide rules relating to the availability of information in conformity with that Freedom of Information amendment.

After the Board has issued an order determining excessive profits, a contractor or subcontractor may, within 90 days from the date of mailing of the notice of the order of the Board, file a petition with the Court of Claims for a redetermination of the amount of such excessive profits. Section 108 of the Act provides that within 10 days after a petition is filed with the court, the petitioner must file a bond in such amount as may be fixed by the court. The Court of Claims is to have exclusive jurisdiction to determine the amount of excessive profits received or accrued by a contractor or subcontractor in these cases. The Court of Claims may determine that the amount of excessive profits is less than, equal to, or greater than the amount determined by the Board, or it may determine that there are no excessive profits.

The Renegotiation Amendments of 1971, in transferring jurisdiction over petitions for redeterminations of Renegotiation Board determinations from the Tax Court to the Court of Claims, reiterated the congressional policy that the court proceeding is not to be treated as a proceeding to review the determination of the Renegotiation Board,

but is to be a *de novo* proceeding. In other words, in excessive profits redetermination cases, there is to be a full *de novo* court trial in the Court of Claims (as under the Tax Court). The decision of the Court of Claims is to be subject to review only by the Supreme Court upon certiorari in the manner provided in the U.S. Code for the review of other cases in the Court of Claims. However, unlike the rules of procedure applicable to cases before the Tax Court, the decision of the Court of Claims in *Lykes Bros. Steamship Co.* v. *U.S.* (Ct. Cl. No. 594–71, 198 Ct. Cl. 312, 459 F. 2d 1393 (1972) held that the burden of proof in renegotiation cases before the Court of Claims is on the Government rather than on the contractor (as under the Tax Court).

B. BRIEF HISTORY OF RENEGOTIATION

Renegotiation procedures under the Renegotiation Act of 1951 are similar to those which prevailed (after amendment) under an earlier renegotiation statute enacted in 1942. Although a few earlier attempts had been made in the 1930's to limit contractors' profits on contracts with the Government,[1] the 1942 Act was the first renegotiation statute. As originally enacted, it provided for renegotiation on a contract-by-contract basis by the procurement officials of the departments involved. However, about 6 months after enactment it was amended to place renegotiation on what is now known as a fiscal-year basis. Subsequent amendments extended renegotiation to the end of 1945, prescribed certain factors which were to be taken into consideration in determining excessive profits, and also provided for *de novo* redetermination proceedings before the Tax Court.

In 1948, a new Renegotiation Act was passed; it was applicable principally to certain Air Force contracts for aircraft procurement. Later in the same year, however, it was amended to authorize the Secretary of Defense to extend it to other contracts, and subsequent amendments made it applicable to all negotiated Department of Defense contracts entered into during the Government's fiscal years of 1950 and 1951. The administration of this Act was placed under the Secretary of Defense, who established departmental renegotiation boards which were subject to review by the Military Renegotiation and Review Board.

The Renegotiation Act of 1951 granted renegotiation authority effective with respect to renegotiable sales (minimum of $250,000 per fiscal year) received or accrued on or after January 1, 1951. This Act expired on December 31, 1953, but 8 months thereafter it was amended and extended for one year until December 31, 1954. At that time, the minimum amount renegotiable under the Act was raised from $250,000 to $500,000. In addition, the 1954 amendments enlarged the exemption for contracts not connected with the national defense, modified the partial exemption for sales of durable productive equipment, provided an exemption for standard commercial articles, and modified the exemption for contracts with common carriers for transportation.

[1] For example, the Congress had, prior to World War II, enacted the Vinson-Trammell Act of 1934 and the Merchant Marine Act of 1936. These acts limited profits on contracts in excess of $10,000 for the construction of vessels and aircraft, with contractors agreeing to refund to the Treasury all profits in excess of 10 percent of the total contract price with respect to the major contracts, and 12 percent of such total on aircraft contracts. These profit-limiting provisions were suspended by the Renegotiation Act of 1951, so long as the act is in effect.

In August of 1955, 7 months after the Act had expired, it was amended and extended for a period of 2 years from its previous expiration date, or until December 31, 1956. These amendments broadened the renegotiation provisions which suspend the profit limitations of the Vinson-Trammell and Merchant Marine Acts (footnote 1, *supra*) to suspend those limitations where the sales were exempt under the standard commercial articles exemption. The 1955 amendment also broadened the standard commercial articles exemption to include standard commercial services, added an exemption for certain construction contracts let by competitive bidding, and further modified the exemption for sales of durable productive equipment.

In 1956, the 1951 Act was extensively amended and further extended for a period of 2 years, to December 31, 1958. These amendments reduced the number of departments whose contracts were subject to the Act, provided for a 2-year carryforward of losses on renegotiable business, raised the "floor" from $500,000 to $1,000,000, and modified the provisions relating to the computation of the aggregate amounts received from persons under common control for purposes of applying the "floor." The 1956 amendments also made technical amendments to the mandatory exemption for certain subcontracts related to contracts exempt from the Act, substantially modified the exemption for standard commercial articles and services, and instituted a requirement that the Board file annual reports of its activities with Congress.

In September of 1958, the Act was amended to bring the National Aeronautics and Space Administration under its coverage, and it was extended for a period of 6 months, or until June 30, 1959. Amendments made in July of 1959 extended the Act for 3 years, or until June 30, 1962, and extended the period for carryforward of losses from 2 to 5 years.

Amendments enacted in 1962, 1964, 1966, 1968, 1971, 1973, and 1974 extended the Act for periods ranging from one year to 3 years, with 2 years the most frequent. The present extension enacted in 1974 expires on December 31, 1975.

The 1962 amendments also provided for review by the U.S. Court of Appeals, with respect to material questions of law, of determinations of excessive profits by the Tax Court. The 1964 amendments also provided that contracts and subcontracts of the Federal Aviation Agency would be included in the Act's coverage with respect to amounts received or accrued after June 30, 1964.

In the 1968 legislation, certain changes were made with respect to the exemption for standard commercial articles and services. The amendment increased the percentage of sales of an item which must be nonrenegotiable (i.e., commercial or to noncovered Government agencies) in order for the exemption to apply, from 35 percent to 55 percent. Further, the exemption was not to apply if the article or service was sold to the Government at a higher price than charged to a civilian commercial purchaser. In addition, two other modifications in the exemption for articles were made: (1) the alternate period (the current year or preceding year) with respect to which the percentage test may be applied was removed (so that the test applied only to the year under review); and (2) the exemption of "like" articles was removed

as being unnecessary in view of the exemption for a "class" of articles. Finally, a reporting requirement was added whereby contractors who self-apply the exemption for standard commercial articles are to furnish information on the exemption to the Board, if the effect of the self-application is to reduce the total renegotiable sales below the $1,000,000 statutory "floor."

The 1971 amendments provided or a transfer of jurisdiction over appeals of renegotiation cases from the Tax Court to the Court of Claims (effective July 1, 1971), and also increased the rate of interest charged by the Board where cases are appealed by the contractor to the court from 4 percent to a prevailing rate as set by the Secretary of the Treasury. The rate is to be set at 6-month intervals and is to be based upon current rates of interest on new private commercial loans with maturity of approximately 5 years.

C. DATA ON OPERATIONS OF THE RENEGOTIATION BOARD: FISCAL YEARS, 1968–1975 [1]

1. Filings With the Renegotiation Board

All contractors having renegotiable business in excess of the statutory minimum (the "floor") must file a report with the headquarters office of the Renegotiation Board. Contractors whose renegotiable sales are below that minimum amount are not required to file reports with the Board, but they may do so if they desire (and a number of contractors in this category do elect to file a report). During fiscal years 1968 through 1975, the number of reports filed with the Board were as follows:

RENEGOTIATION REPORTS FILED

Fiscal year	Total	Above the floor	Below the floor
1968	6,880	4,552	2,328
1969	7,236	5,030	2,206
1970	7,639	5,085	2,554
1971	7,414	5,267	2,147
1972	6,948	4,874	2,074
1973	5,492	3,910	1,582
1974	5,309	3,665	1,644
1975	5,450	3,708	1,742

The contractors' reports are screened at headquarters, and each filing showing renegotiable business above the statutory minimum is reviewed to determine the acceptability of the segregation which the contractor has made of sales and his allocation of costs. This information is then evaluated to determine whether the filing should be assigned to a regional board for renegotiation, or whether it may be cleared at headquarters without assignment. If the latter determination is made (for example, because a report shows a loss or obviously nonexcessive profit), then headquarters will complete action on the filing by issuing to the contractor a notice of clearance without assignment. (The Board generally has one year after a contractor's

[1] Data for fiscal years 1968–1974 are from the respective Annual Reports of the Renegotiation Board. In addition, some data for fiscal year 1975 are presented, which was supplied by the Board's Office of Planning and Analysis (and is preliminary).

inancial statement is filed to commence renegotiation.) The following tabulation, for the Board's 1968 through 1975 fiscal years, shows the number of above-the-floor filings made by contractors (including brokers and manufacturers' agents) which were screened at headquarters, the number cleared without assignment and the number assigned to a regional board for renegotiation, as well as the average time required for the screening of a filing:

ABOVE-THE-FLOOR FILINGS SCREENED BY THE BOARD AND ASSIGNED TO A REGIONAL BOARD

Fiscal year	Total screened at headquarters	Cleared without assignment		Assigned to a regional board		Average number of days required for screening
		Number	Percent	Number	Percent	
1968	4,354	3,527	81.0	827	19.0	39
1969	4,828	3,858	79.9	970	20.1	54
1970	4,853	4,163	85.8	690	14.2	82
1971	5,442	4,827	88.7	615	11.3	87
1972	4,630	4,197	90.6	433	9.4	86
1973	3,108	2,785	89.6	323	10.4	121
1974	3,586	2,803	78.2	783	21.4	167
1975	3,254	2,381	79.3	673	20.7	[1]

[1] Not available.

The fiscal 1974 and 1975 data show a reversal of the declining trend in number of cases assigned to the regional boards and also the declining percentage of cases assigned over the fiscal years 1969–1973. The Board reports that this is a result of increased scrutiny of cases in the screening process, as well as the reversal of the previous declining trend in DOD procurement. The changes in the Board's screening process have also contributed to the increase in days required for completing screening.

2. *Renegotiable Sales and Profits*

The amounts of renegotiable sales for nonagent contractors, in total and by contract type, reviewed by the Board during fiscal years 1968 through 1975, were as follows:

RENEGOTIABLE SALES REVIEWED, BY CONTRACT TYPES

[In millions of dollars]

Fiscal year	Total sales	Types of contracts				
		Cost-plus-fixed-fee	Cost-plus-incentive	Fixed price	Fixed-price incentive	Other
1968	38,773	5,556	4,664	22,449	3,962	2,142
1969	48,495	5,970	5,073	27,669	6,382	3,401
1970	48,008	6,310	5,551	27,468	6,799	1,880
1971	51,639	6,514	4,488	28,750	7,956	3,931
1972	31,264	4,027	2,633	17,252	5,300	2,052
1973	28,335	5,368	3,438	13,010	5,010	1,509
1974	40,229	5,787	4,539	18,848	7,204	3,851
1975	[2] 21,110	2,609	1,703	10,847	3,687	2,224

[1] "Other" contracts include price redetermination, time and material contracts, and other miscellaneous types.
[2] A number of large contractor filings received in 1975 were still in the screening, and therefore not screened in 1975.

The amounts of renegotiable sales and profits and losses on contracts involved in the above-the-floor filings (other than filings by brokers or manufacturers' agents) screened during fiscal years 1968 through 1975, were as follows:

RENEGOTIABLE SALES, PROFITS, AND LOSSES IN ABOVE-THE-FLOOR NONAGENT FILINGS SCREENED

[Dollar amounts in millions]

Fiscal year	Number of nonagent filings screened	Renegotiable sales and profits			
		Net profit reports		Net loss reports	
		Sales	Profits	Sales	Losses
1968	4,027	$35,260	$1,909	$3,513	$215
1969	4,452	43,226	2,445	5,269	256
1970	4,400	38,752	1,981	9,256	461
1971	5,009	40,911	2,018	10,728	700
1972	4,227	22,303	993	8,960	575
1973	2,891	22,831	1,105	5,504	427
1974	3,344	34,111	1,597	6,118	459
1975	2,385	18,315	979	2,795	24

The profit and loss figures in the preceding table are net figures, reflecting the fact that both profit and loss contracts may be involved in a contractor's filing for a given year. Also, the figures are based on tax cost allowances required for renegotiation purposes, which differ in significant respects from costs allowable for procurement purposes by the Armed Services Procurement Regulations (ASPR) and the Federal Procurement Regulations (FPR).

The amounts of renegotiable sales and profits and losses reported in filings which the Board receives in a given fiscal year generally relate to contractors' receipts or accruals during the preceding 2 calendar year. Thus, filings received by the Board during fiscal year 1974 would relate to renegotiable receipts and accruals during the contractor's 1972 and 1973 years. This time lag occurs because contractors are not required to file a report with the Board until 4 months after their business year ends (on or before the first day of the fifth month), and also because many of them request and are granted extensions of time for filing their renegotiation statements when they are granted extensions by the IRS for filing their tax returns.

3. Cases Assigned to Regional Boards and Reassigned Back to the Board

Cases assigned to regional boards generally involve substantial questions, and thus require more extensive examination and analysis than those which are cleared at the headquarters office. The average time for processing such cases from filing to determination was 38 months for fiscal year 1974, although the time required for a given case might vary considerably from that average. This was an increase from the average time of 29 months for fiscal year 1973, 19 months for fiscal year 1970, and 15 months for fiscal year 1967. The headquarters formally commences renegotiation when the case is assigned to a regional board for full-scale renegotiation. The regional board then obtains

such additional information from the contractor as it may need; and it then makes a finding regarding the amount of the contractor's excessive profits, if any. (In the absence of an extension for filing, the Board must obtain an agreement or issue an order or a clearance within two years after commencing renegotiation.)

Until fiscal year 1973, the regional boards had been delegated final authority to issue clearances, make refund agreements or issue final orders in cases involving aggregate renegotiable profits of $800,000 or less (the so-called "Class B" cases). During fiscal year 1973, the Board reserved the authority to itself to issue final orders in such cases. If a recommendation of the regional board is not acceptable to the contractor in such Class B cases, the case is reassigned from the regional board to the Board for further processing and completion. All "Class A" cases (those with renegotiable profits of more than $800,000) must be reassigned to the Board for a final determination. If a determination of excess profits is made and the contractor will not enter into an agreement to refund such profits, the Board issues an order directing a payment of the refund.

For fiscal years 1970 through 1975, the following tabulation shows the number of cases assigned to and completed by the regional boards (and the change in case backlog), the disposition of those completed cases, and the number of cases completed at headquarters after reassignment to it:

A. RENEGOTIATION CASES CONSIDERED BY THE REGIONAL BOARDS

Fiscal year	Cases assigned	Cases completed	Case backlog	Disposition of completed cases				
				Regional refund agreements	Regional clearances	Regional decisions not to proceed	Transferred to headquarters	
							Impasse	Clearances
1970	690	687	1,294	62	281	6	90	248
1971	615	740	1,169	86	243	9	146	256
1972	433	677	925	118	160	11	221	167
1973	323	583	665	112	68	4	93	306
1974	783	407	1,041	25	130	14	30	208
1975	673	405	1,308	8	122	17	57	201

B. RENEGOTIATION CASES COMPLETED AT HEADQUARTERS AFTER FURTHER PROCESSING

Fiscal year	Total	Decision not to proceed	Clearance	Refund		
				Total	Agreement	Order
1970	342	4	247	91	31	60
1971	362	1	260	101	31	70
1972	333	11	207	115	34	81
1973	192	1	86	105	81	24
1974	371	0	166	205	101	104
1975	199	(1)	(1)	(1)	(1)	(1)

[1] Not available.

4. Excessive Profits Determinations

The following table shows the number and amounts of excessive profits determinations (before adjustments for Federal income taxes) made by agreement and by unilateral order, as well as the totals after Federal income tax credits by the Board during fiscal years 1968–1975:

RENEGOTIATION BOARD DETERMINATIONS OF EXCESSIVE PROFITS

[Dollar amounts in thousands]

Fiscal year	Number of determinations			Amounts of determinations [1] [2]			Totals after Federal tax credits [3]
	Total	By agreement	By unilateral order	By agreement	By unilateral order	Total excessive profits	
1968	46	27	19	$6,200	$16,870	$23,070	$13,300
1969	82	54	28	9,880	11,470	21,350	11,700
1970	123	68	55	13,120	20,330	33,450	19,000
1971	149	87	62	42,780	22,450	[4] 65,240	34,100
1972	178	110	68	21,120	19,060	40,190	20,800
1973	86	77	9	25,430	2,570	28,000	12,800
1974	153	59	94	23,560	46,650	70,210	34,600
1975	52	27	25	10,800	16,880	27,670	17,500

[1] Rounded to the nearest 10 thousands.
[2] Totals after State income tax adjustments but before Federal tax credits.
[3] Rounded to nearest 100 thousands.
[4] $26,500,000 was from one case.

It should be noted that the excessive profits determinations in a given fiscal year generally relate to amounts received by contractors during the preceding three to six contractor fiscal years (or more). To illustrate, excessive profit determination in fiscal year 1974 generally related to amounts received or accrued during contractor fiscal years 1968–1971 under contracts awarded in those or prior years. This substantial time lag between the awarding of a contract and an excessive profits determination with respect to amounts received under the contract is a result of the combined effect of the time lag between the receipt of amounts under contracts subject to renegotiation and the reporting of those amounts by contractors to the Renegotiation Board, as well as the time required to process a case from filing to determination. The time between the receipt or accrual of renegotiable business by a contractor and final determination is also affected by extensions for filing contractor tax returns (many of the large corporations may receive tax extensions for up to two years).

5. Appeals to the Courts

In those cases where a contractor does not agree with the Board's determination of excessive profits (that is, where the Board has issued a unilateral order directing the contractor to refund such amounts to the Government), he may appeal to the Court of Claims for a *de novo* redetermination.[2] In such a proceeding, the Court of Claims may

[2] Appeal was to the Tax Court prior to July 1 ,1971.

determine an amount of excessive profits which is less than, equal to, or greater than the amount determined by the Board (or the Court may determine no excessive profits). The following tabulation, for fiscal years 1968 through 1975, shows the number and amount of the Board's determinations appealed to the Tax Court (1968–1971) and Court of Claims (1972–1975), and the number and amounts involved in cases pending before the court at the end of the fiscal year:

APPEALS OF RENEGOTIATION BOARD DETERMINATIONS TO THE COURTS

Fiscal year	Unilateral orders appealed to Tax Court and Court of Claims		Cases pending in Tax Court and Court of Claims at the end of fiscal year	
	Number	Amount of determinations (thousands) [1]	Number	Amount of determinations (thousands)
Tax Court:				
1968	15	$16,517	32	$28,934
1969	25	11,000	41	51,525
1970	43	17,698	66	40,759
1971	44	19,091	104	47,591
Court of Claims:				
1972	54	16,211	129	62,596
1973	3	1,377	104	41,963
1974	94	41,091	151	77,123
1975	39	14,691	157	72,567

[1] After adjustment for non-Federal income taxes.

6. Board Expenses and Personnel

The number of personnel employed by the Board at its headquarters office at its regional boards on June 30 of each of the fiscal years 1968–1975, and the Board's expenses for fiscal years 1968–75, were as follows:

RENEGOTIATION BOARD PERSONNEL AND EXPENSES

Fiscal year	Personnel			Expenses (thousands)		
	Total	Head-quarters	Regional boards	Total	Salaries	Other
1968	184	96	88	$2,626	$2,344	$282
1969	199	96	103	3,069	2,673	396
1970	232	112	120	3,967	3,481	496
1971	239	114	125	4,530	3,990	540
1972	223	109	114	4,754	4,148	606
1973	201	106	95	4,831	4,121	711
1974	183	104	79	4,684	3,941	743
1975	194	108	86	5,298	4,601	697

7. Board's Projected Workload, Fiscal Years 1976 and 1977

The Renegotiation Board estimates that during each of the fiscal years 1976 and 1977 it will receive about 3,700 filings, or about the same level as the 3,708 filings in fiscal year 1975. However, it is estimated that there will be a larger amount of renegotiable sales reported in fiscal years 1976 and 1977 than in fiscal year 1975. In addition, the Board estimates that the number of cases assigned to the regional boards for full-scale renegotiation will be down somewhat in fiscal years 1976 and 1977, as compared to fiscal years 1974 and 1975. The Board's estimates for fiscal years 1976 and 1977, and the actual figures

in fiscal years 1972–1975 of the number of above-the-floor filings received and screened, the amounts of renegotiable sales represented in the filings screened, the number of cases assigned to regional boards, the number of cases completed by the regional boards, and the backlog of regional cases are as follows:

RENEGOTIATION BOARD'S RECENT AND PROJECTED WORKLOAD

[Dollar amounts in millions]

	Filings received	Filings screened	Renegotiable sales screened	Cases assigned to a regional board	Cases completed by regional boards	Backlog of regional cases
Fiscal year:						
1972	4,874	4,630	$31,264	433	677	925
1973	3,910	3,108	28,335	323	583	665
1974	3,665	3,586	40,229	783	407	1,041
1975	3,708	3,254	[2] 21,110	673	405	1,308
1976 (projected) [1]	3,700	3,450	35,000	690	560	1,438
1977 (projected) [1]	3,700	3,900	40,000	690	840	1,266

[1] The number of projected cases to be completed assumes a significant increase in the Board's staff.
[2] The amount of sales screened during fiscal 1975 was relatively low because a number of large contractor filings received were still in the screening backlog, and therefore were not screened during fiscal 1975.

PART III:

ANALYSIS OF PRESENT LAW AND PROPOSALS TO AMEND THE RENEGOTIATION ACT OF 1951

A. EXTENSION OF THE RENEGOTIATION ACT

The principal issues include whether to extend the Renegotiation Act of 1951, and if so, for how long it should be extended; and also whether renegotiation is still needed in peacetime military procurement.

Present Law

The Renegotiation Act of 1951, as amended, presently is scheduled to expire December 31, 1975 (sec. 102 of the Act), unless extended by Congress. The Act has been extended a total of 12 times since enactment, with such extensions ranging from 6 months to 3 years at a time. The latest extension was enacted in 1974 (Public Law 93–329), which extended the Act for 18 months, or from June 30, 1974 through December 31, 1975. After this expiration date, in the absence of a further extension, the Renegotiation Board will be unable to require new filings from contractors and subcontractors covered by the Act. (However, because of a backlog of cases from previous years, the Board will continue in existence until it disposes of this backlog.)

Proposals

Previous congressionally-sponsored studies

In 1971 the Subcommittee on Government Activities of the House Government Operations Committee recommended that the Renegotiation Act be made permanent.[1] The Commission on Government Procurement subsequently recommended in 1972 that the Act be extended for periods of five years.[2] More recently, in 1973 the GAO, instead of recommending a specific time period, indicated simply that future extensions should be for more than two years at a time, if the Act is extended.[3]

Current congressional proposals

Two bills introduced in the 94th Congress would remove the expiration date provision from section 102 of the Renegotiation Act of 1951: H.R. 5940 (hereinafter referred to as the Burton bill) was introduced by Congressman John L. Burton on April 15, 1975; and H.R. 9534 (hereinafter referred to as the Minish bill) was introduced on Sep-

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[1] *Efficiency and Effectiveness of Renegotiation Board Operations,* 6th Report by the House Committee on Government Operations, Subcommittee on Government Activities (House Report 92–758, December 16, 1971), pp. 10, 14–15. (Hereinafter referred to as Government Operations Report.)

[2] *Report of the Commission on Government Procurement,* Vol. 4 Part J. ch. 4 (December 1972), pp. 188–9. (Hereinafter referred to as Commission Report.)

[3] *The Operations and Activities of the Renegotiation Board,* Report to the Congress by the Comptroller General of the United States (General Accounting Office Report No. B–163520, May 9, 1973), p. 47. (Hereinafter referred to as GAO Report (1973).)

tember 10, 1975, by Congressman Minish, and cosponsored by Congressmen Mitchell (of Maryland), Derrick, Hayes (of Indiana), Gonzalez, St Germain, Evans (of Indiana), McKinney, John L. Burton, and Brooks.

Renegotiation Board

The current legislative proposal by the Board (as approved by the Office of Management and Budget (OMB)) is to extend the Act for 5 years, or through December 31, 1980. In a letter to OMB on March 27, 1975, however, the Board proposed that the Act be extended indefinitely. Previously, the Board had recommended a permanent extension in 1968 and 1971 (with OMB approval).

Industry representatives

Generally, in prior years and in current testimony, industry representatives have recommended that the Act be allowed to expire, as no longer needed. Most have indicated, however, that if the Act were to be extended again, then it should be extended only for a short period (such as one, two or three years) to allow for further evaluation of the need for the Act in peacetime procurement; on the other hand, some industry representatives have suggested extending the Act possibly as long as 5 years, if it is to be extended at all.

Staff Analysis of Proposals

All three of the previous congressionally-sponsored studies concluded that the congressional policy of frequent, short extensions of the Act has created an atmosphere of uncertainty and encouraged a philosophy throughout the Board's more than 20-year history of simply getting through the current workload. In the absence of a relatively long or permanent extension, the Board has put a very low priority on long-term planning or development of guidelines on the application of the statutory factors in the determination of excessive profits. In the Board's year-to-year existence, the apparent emphasis has been on reviewing the largest number of filings possible within the shortest period of time in order to show Congress that it was doing its job.

To a large extent, reluctance of Congress to cloak the Board with permanency appears to have stemmed from a genuine conviction that periodic review was necessary in view of the large delegation of judgment vested in the Board by Congress.[4] However, it is the opinion of each of the above-mentioned study groups reviewing the Board that in discouraging long-term planning and codification of past opinions, the element of judgment in determining excessive profits has probably been expanded over the years rather than curbed by this policy. The consensus of opinion of these studies is that Congress could retain oversight authority over the Board even while extending the Board for longer periods than two years, particularly if this were accompanied by a clear congressional directive to the Board to begin the long overdue task of codifying its experience and publishing guidelines with re-

[4] Cf. *Report on the Renegotiation Act of 1951*, a report to the Congress by the staff of the Joint Committee on Internal Revenue Taxation (House Document No. 322, 87th Cong., 2d Sess., Jan. 31, 1962), p. 11; *Renegotiation Amendments Act of 1968*, Report of the House Committee on Ways and Means (House Rept. 90–1398, 90th Cong., 2d Sess., May 20, 1968), p. 4; *Renegotiation Amendments of 1971*, Report of the Senate Committee on Finance (Senate Rept. 92–245, 92d Cong., 1st Sess., 1971).

spect to the application of the statutory factors in determining whether excessive profits exist (as was suggested by the Joint Committee staff's 1974 preliminary report on renegotiation [5]).

Proponents of indefinite extension of the Act assert that renegotiation is needed on a permanent basis because of a continued high level of defense-related procurement of complex and new weapons systems and supplies.[6] They contend that both the complexity of products and the negotiated nature of a large share of defense and space-related procurement contribute to uncertainties in cost and pricing data, and therefore the resulting profits earned on much of the procurement cannot be forecast by the Government with precision at the time of procurement.[7] It is also argued that this potential for unreasonable profits may be the case even with advertised military procurement and in procurement of products of a more commercial nature because of the impact of Government purchasing that may upset the normal competitive market place pricing. The view is that renegotiation is still needed even with the improvements in procurement policies and techniques and with the degree of audits of defense contracts now conducted by the Defense Contract Audit Agency (DCAA), GAO, etc.

In addition, proponents of a permanent Act contend that the temporary, uncertain nature of previous congressional extensions has hindered the recruitment of competent and committed personnel and attracting top-flight business and professional persons as Board members.

Opponents of extension of the Renegotiation Act maintain that renegotiation is not needed in peacetime procurement because of the absence of emergency wartime procurement and the lessening of sudden disruptions of the private marketplace by Government purchases of items in short supply or of specialized military products needed in a short time. Moreover, they believe that there have been significant improvements in Government procurement policies and practices since the wartime enactment of renegotiation in 1951 (and the World War II renegotiation legislation). They point out that the Truth-in-Negotiations Act (Public Law 87–653) requires certification of cost or pricing data for negotiated contracts of $100,000 or more, and that such data must be furnished on a prescribed DOD contract pricing proposal form. Further, they emphasize the oversight of contract performance through on-going audits by DCAA, as well as post-performance audits by DCAA and GAO to determine compliance with the Truth-in-Negotiations Act. In addition, they note that some contractors are

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[5] *Staff Review of Recommendations Made on the Renegotiation Process: A Preliminary Report* by the staff of the Joint Committee on Internal Revenue Taxation for the House Committee on Ways and Means and the Senate Committee on Finance, May 14, 1974, p. 2.

[6] Total DOD procurement rose from $28 billion in fiscal 1965 to a Vietnam-buildup peak of $44.6 billion in fiscal 1967; it then declined slightly to $43.8 billion in fiscal 1968 and to $42 billion in fiscal 1969; it declined further to $34.5 billion in fiscal 1971, before increasing to $38.3 billion in fiscal 1972 and $40.1 billion in fiscal 1974; the level then rose to $45.8 billion in fiscal 1975, which exceeded the fiscal 1967 Vietnam peak procurement as well as the Korean War peak of $43.6 billion in fiscal 1952. (Office of the Secretary of Defense (Comptroller), *Military Prime Contract Awards* (various fiscal years.)

[7] For example, negotiated DOD procurement accounted for almost 92 percent of the value of the contracts (excluding intragovernmental contracts) for fiscal 1973 and 1974, which was up from almost 90 percent for fiscal 1972, 89 percent for fiscal 1969, 87 percent for fiscal 1967, and about 82 percent for fiscal 1965. This was down from 88 percent in fiscal 1961. (Office of Secretary of Defense, note 6, *supra*).

In addition, negotiated NASA contracts accounted for between 98 and 99 percent of the value of NASA's procurement during fiscal years 1968–74, as compared to 91 percent in fiscal 1961. (NASA *Annual Procurement Report*, various fiscal years.)

subject to review on their compliance with the Cost Accounting Standards Board's rules on standards for cost accounting and allocation of such costs to negotiated defense contracts or subcontracts of $100,000 or more (Public Law 91–379).[8]

On the other hand, it is pointed out that the Truth-in-Negotiations Act and the Cost Accounting Standards Board's rules do not apply to non-negotiated contracts (i.e., formally advertised contracts), where it is maintained that the impact of sudden Government procurement can result in multiple awards so that part of the advertised procurement is awarded at prices above the low bid. In addition, the sudden increase in procurement may result in a rapid increase in contract awards granted to a given contractor, which would tend to reduce per unit costs substantially during the procurement build-up and thereby result in an unintended rise in profits (or a "windfall" profit). For example, a recent study by the GAO (still in draft) of the Board's determinations of excessive profits during fiscal years 1970–1973 indicates that a significant portion of such determinations were derived from "competitively bid" fixed-price contracts.

Even without a rapid procurement buildup, proponents believe that renegotiation is needed in cases where the size of Government buying may distort normal competitive market conditions or where the Government is, for example, purchasing parts and accessories from a sole-source supplier.

Staff Recommendation and Reasons

The staff believes that the Renegotiation Act should be extended for a period of at least 5 years, rather than being made permanent at this time because of the need for further congressional reviews as to how the Board adapts to the recommended changes in the Act and in Board organization and operation. The staff considers a shorter extension of 2 or 3 years to be too short for proper Board planning and personnel recruitment, as well as being too short a time for an evaluation of the Board's progress in responding to the recommended changes. Since a 5-year extension would place the expiration date at the end of 1980, and since 1980 is an election year, the staff recommends that the Renegotiation Act of 1951 be extended for a period of 6 years, or through December 31, 1981.

In addition, the staff concludes that renegotiation should not be made permanent at this time because of the lack of adequately-developed guidelines in applying the "statutory factors" and because renegotiation procedures involve considerable judgmental evaluations. Moreover, there are areas that need further review before it is decided to make renegotiation permanent. The staff believes that the evidence still shows that there is a continued need for renegotiation to protect against "excessive profits" being carried by Government contractors.

[8] In fiscal 1975, the Cost Accounting Standards Board amended its regulations to provide an exemption for any contract or subcontract of $500,000 or less, unless it is awarded to a contractor who, on the date of such award, (1) has already received a contract or subcontract in excess of $500,000, and (2) has not received notification of final acceptance of all work under that contract and other contracts awarded after Janury 1, 1975, which were subject to the Cost Accounting Standards clause. Cost Accounting Standards Board, *Progress Report to the Congress 1975,* August 15, 1975, pp. 14–15.

B. AGENCIES COVERED BY THE RENEGOTIATION ACT

The principal issues include whether to extend coverage of the Renegotiation Act to other (or all) Government agencies, to retain present coverage, or to eliminate certain nondefense agencies from renegotiation (so that the Act would therefore concentrate solely on defense-related contracts and subcontracts).

Present Law

At present, only contracts (and related subcontracts) entered into with the following "Departments" (or agencies) are covered by the Renegotiation Act of 1951, as amended (sec. 103(a) of the Act): the Department of Defense, Departments of the Army, Navy and Air Force, the National Aeronautics and Space Administration, the General Services Administration, the Maritime Administration, the Federal Maritime Board (reorganized in 1961 into the Maritime Subsidy Board and the Federal Maritime Commission), the Federal Aviation Agency (now Administration), and the Atomic Energy Commission.[1]

(The AEC was reorganized in 1974 by Congress into the Nuclear Regulatory Commission and the Energy Research and Development Administration.[2])

Contracts (and related subcontracts) with DOD (and the Army, Navy and Air Force), GSA and AEC were specifically subjected to renegotiation by the Renegotiations Act of 1951. The Maritime Administration and the Federal Maritime Board were specifically retained in the Act in 1956 as the Department of Commerce was deleted in general (Public Law 84–870); NASA was included in 1958 (Public Law 85–930); and the FAA was added in 1964 (Public Law 88–339). With respect to GSA, the Renegotiation Board has exempted (under the authority granted by sec. 106(e)(6) of the Act) all GSA contracts except those entered into by that agency on behalf of DOD (and the Army, Navy and Air Force), NASA and AEC.[3] The Board has also used this authority to exempt contracts entered into under the civil functions of the U.S. Army Corps of Engineers.[4] Further, the Board has exempted (under section 106(d)(3) of the Act) all operating differential subsidy contracts of the Maritime Administration under 46 U.S.C. 1171, as amended.[5]

Proposals

Previous congressionally-sponsored studies

The primary source for the proposal to extend renegotiation coverage to all Government agencies appears to be the Commission on Gov-

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[1] Section 103(a) of the Act also includes "any other agency of the government exercising functions having a direct and immediate connection with the national defense which is designated by the President during a national emergency," but that such designation is to cease effect on the last day of the month during which the national emergency is terminated.

[2] "Energy Reorganization Act of 1974" (H.R. 11510, 93d Cong., 1st Sess., Public Law 93–438; Oct. 11, 1974).

[3] R.B. Reg. § 1453.5(b)(8).

[4] Other than contracts under certain listed projects that the Board has concluded were "directly and immediately connected with defense," except that the exemption has not applied to the part of the given project that was for work or materials required for navigation or flood control works, located elsewhere than on the site of the main power facility (as determined by the Corps of Engineers) (R.B. Reg. § 1453.5(b)(12)).

[5] R.B. Reg. § 1455.4(b)(1).

ernment Procurement,[6] with the GAO in effect endorsing the Commission's recommendation.[7]

The House Government Operations Committee did not mention the issue of expansion of renegotiation coverage to other agencies.

Current congressional proposals

Neither the Burton bill (H.R. 5940) nor the Minish bill (H.R. 9534) mention modifying the present agency coverage of the Act.

Renegotiation Board

The current position of the Regulation Board (as approved by OMB) is to retain the present coverage of the Act. In its March 27, 1975, letter to OMB, however, the Board had recommended extending the coverage to all Government agencies.

Industry representatives

Generally, industry representatives would prefer eliminating nondefense agencies (such as NASA, FAA, and GSA) from coverage of the Act. If that is not possible, they recommend that no additional agencies be included in the Act's coverage.

Other proposals

A former official of the Board has recommended that the civil functions of the Army Corps of Engineers be covered (presently, exempted by Board regulations).

Staff Analysis of Proposals

Although Congress enacted profit-limiting legislation in the 1930's in connection with military naval and aircraft construction (e.g., the Vinson-Trammell Act of 1934 and the Merchant Marine Act of 1936), the primary development of the renegotiation concept has occurred in the wartime conditions of World War II and the Korean War. In other words, renegotiation as a concept has been associated principally with military procurement. The theory has been that defense production such as that required for modern armed forces of necessity involves large amounts of money and a degree of specialization which makes true free-market competitive bidding oftentimes impossible.

In fact, the present Act, dating back to 1951 and the Korean War, declares in its preamble that it is a matter of national policy to eliminate excessive profits in the general area of defense-type procurement.[8]

Opponents of expanding coverage of the Renegotiation Act to other civilian-type agencies therefore emphasize that the main thrust of renegotiation has been with respect to military procurement, and especially during military buildup periods associated with wartime conditions where the Government awards contracts for goods and services under emergency conditions. In addition, military procurement in relatively peacetime conditions has involved contracts of large-dollar amounts for complex aircraft, ships, missiles and other high-technology weapons systems and products not normally produced in the commercial marketplace. According to the defense-oriented ra-

[6] Commission Report (1972), pp. 188–189.
[7] GAO Report (1973), p. 47.
[8] Section 101 of the Act (50 U.S.C. App. § 1211).

tionale, renegotiation should not apply to any civilian agency procurement. Thus, many industry representatives contend that even the civilian agencies presently covered (NASA, GSA, AEC, the Maritime Administration, and the Federal Maritime Board) should be eliminated from the Renegotiation Act's coverage.

It should also be pointed out, however, that from the beginning of the 1951 Act, renegotiation has applied, both by Act of Congress and Presidential designations, to agencies not normally considered defense-oriented. For example, the line between defense and nondefense may be very thin in the case of the Canal Zone Government or the Coast Guard. On the other hand, the Department of Commerce, the Geological Survey, the Reconstruction Finance Corporation, the Housing and Home Finance Agency, the Tennessee Valley Authority, and the Bureau of Mines would normally be considered civilian agencies. Yet each of these departments and agencies has at one time or another, whether by Executive Order or Act of Congress, been subject to the jurisdiction of the Renegotiation Act.[9]

In terms of procurement, the two main nondefense-related agencies (other than the old AEC, which was in the 1951 Act and considered to be defense-related) now subject to the jurisdiction of the Renegotiation Act are NASA and the FAA. Congress concluded in 1958 and 1964, respectively, that their high procurement volume or relative concentration of spending on complex facilities and equipment involving highly complicated technology and procurement conditions under less than competitive conditions argued for the inclusion of these two agencies in the renegotiation process.

The chief argument made by the Commission on Government Procurement for extending renegotiation to all Government agencies is that, in terms of good financial management, a dollar spent for defense is indistinguishable from a dollar spent by the Government in any other area. It is argued that there should be as much concern that the taxpayers' dollar be spent as prudently as possible in one area of Government spending as any other. In effect, by singling out defense-related spending for special review and treatment, different standards of Government spending are being created. If excessive profits are something to be discouraged and recovered when they occur in connection with the procurement by one Government Department, then both consistency and equity, it is asserted, would require that a similar policy prevail for procurement in every other department.

The underlying economic assumption under this approach is that the Government today is such a large customer that, in effect, true

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[9] The Department of Commerce (except for the Maritime Administration and the Federal Maritime Board), Reconstruction Finance Corporation, Canal Zone Government, and the Housing and Home Finance Agency previously included under renegotiation coverage by Act of Congress were eliminated from such coverage by P.L. 84–870, Aug. 1, 1956. In addition, the following were also eliminated from renegotiation coverage by P.L. 84–870:

The Tennessee Valley Authority, the Coast Guard, Federal Civil Defense Administration and the National Advisory Committee on Aeronautics, designated by Executive Order 10260, dated June 27, 1951; the Defense Materials Procurement Agency, the Bureau of Mines, and the U.S. Geological Survey designated by Executive Order 10294, dated September 28, 1951; the Bonneville Power Administration, designated by Executive Order 10299, dated Oct. 31, 1951; the Bureau of Reclamation, designated by Executive Order 10369, dated June 30, 1951; and the Federal Facilities Corporation, designated by Executive Order 10567, dated Sept. 29, 1954.

At the same time, Congress amended section 103(a) of the Act to limit the discretion of the President to designate for renegotiation coverage during (and for the life of) any national emergency "any other agency of the Government exercising functions having a direct and immediate connection with the national defense. . . ."

market-tested competitive pricing does not exist in many cases when it enters the market, particularly with a sizable demand for a new product or product line. It is argued that the potential for such Government-caused dislocation (whether permanent or temporary), resulting in unfavorable prices being charged the Government and paid for with the taxpayers' dollars, is not limited to defense production.

There is little in the way of hard figures to indicate just how much might be recovered in the way of excessive profits were renegotiation to be extended to include all (or additional) Government agencies. Nor is there any detailed estimate available of how much extra work would be required of the Renegotiation Board were it to be responsible for reviewing all (or additional) Government contractors, with or without the same minimum floors and exemptions as are in effect today for defense-related contractors. In other words, the argument as presented is primarily one of equity or equal treatment for all Government Departments and all contractors doing business with the Government.

Constitutionally, the main test of the renegotiation process occurred in *Lichter, et al, d.b.a. Southern Fireproofing Company v. U.S.*, 334 U.S. 742, decided June 14, 1948. While *Lichter* has been cited in numerous cases since then, in holding that war powers under the Constitution gave Congress the power to support the Armed Forces with supplies and equipment in wartime, the question may be raised as to what the courts might do when presented with a significantly broader renegotiation act in peacetime conditions covering all (or additional nondefense) Government agencies. The Supreme Court has not yet heard a challenge to the inclusion of NASA and the FAA under the purview of the Renegotiation Act.

In response to the 1972 recommendations of the Commission on Government Procurement to extend renegotiation to all Government agencies, the Renegotiation Board General Counsel prepared a memorandum, dated February 8, 1974, which analyzed the Commission's recommendation in terms of the constitutionality of such expansion, an estimate of the additional filings to the Board (and additional renegotiable sales involved), and the potential impact on the Board's workload.[10] The General Counsel's memorandum stated that there "appears to be a valid legal and constitutional method by which renegotiation may be extended to all government procurement."[11] The memorandum indicated further that:

> "This could be accomplished by requiring as a matter of national policy, that all contractors doing business with the Government shall have a contract clause as a condition of qualifying for a Government contract. * * * This approach would require some revisions to the Act to broaden the authority to include the national interest and to extend the requirement for the presence of the clause in all contracts and subcontracts."[12]

The General Counsel's memorandum notes that statistical sampling analysis by the Board's staff resulted in a rough estimate of an addi-

[10] Memorandum from the General Counsel of the Renegotiation Board to a Board "Task Force Study Group" regarding "Extension of Renegotiation Coverage to all Government Agencies" (Commission on Government Procurement Recommendation No. J–4), February 8, 1974.
[11] *Ibid.*, p. 3.
[12] *Ibid.*, p. 4.

tional $7–8 billion in renegotiable sales if the Act were to be extended to cover all Government agencies; however, it was pointed out that this estimate did not take into account the possible exemptions currently available under the Act.[13] Based upon past statistical experience of the Board's excessive profits determinations, the General Counsel indicated that the estimated additional renegotiable sales could have resulted in an annual increase in excessive profits determinations of over $5 million per fiscal year.[14] The memorandum presented an estimate that the Board could expect an increase of 860 filings per year, with a resulting increase of 115 assignments per year to the regional boards; this would require roughly a minimum of 50 additional employees (40 in the regional offices and 10 in the headquarters office) to process the additional filings.[15] The General Counsel indicated that although the Act could be effectively extended" to cover all Government agencies (and thereby eliminate the present unequal treatment of Government contractors), he noted that it is "difficult to draw any conclusions from or establish any recommendations either pro or con regarding the extension of the Act to all Government procurement" because specific data is not available to "demonstrate the existence or nonexistence of excessive profits in those procurement actions with agencies not now covered." [16] The General Counsel concluded:

> "However, there are some economic theories which tend to support the conclusion that the quantity of Government purchases as such (approximately $50 billion) can impact supply and demand situations which could result in profits which are excessive." [17]

As mentioned above under "Proposals," the Renegotiation Board apparently accepted the equity and economic arguments propounded by the Commission on Government Procurement, as the Board recommended to OMB in March 1975 that the Act be extended to all Government agencies:

> "The Board believes that, contracts of large dollar values for supplies and services that are often identical or similar to those procured by agencies covered by the Act, are let by agencies not presently so covered, the unequal treatment imbedded in the present legislation is of some significance. Since the retention of excessive profits on Government contracts and related subcontracts is unacceptable in principle regardless of the agency making the contract, the present limitation . . . is not in the public interest." [18]

The Board's March 27, 1975, letter to OMB also noted that in 1974 in response to a task group appointed by the General Services Administration to develop an executive branch position on the Commission's recommendation to extend renegotiation to all agencies, all but a few Executive agencies supported the Commission's recommended extended coverage of the Renegotiation Act.[19] Apparently, the Board's

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[13] *Ibid.*, p. 7.
[14] *Ibid.*
[15] *Ibid.*, Attachment, section III.
[16] *Ibid.*, pp. 6 and 8.
[17] *Ibid.*, p. 8.
[18] Letter from the Renegotiation Board to OMB, March 27, 1975, p. 6.
[19] *Ibid.*

1975 recommendation to OMB that renegotiation be extended to all Government agencies did not receive such a positive response from the other Executive agencies.

Nondefense procurement totaled $14.2 billion in fiscal 1974; this, however, include $7.4 billion for three of the covered agencies, NASA, GSA and AEC: NASA ($2.4 billion), GSA ($1.6 billion) and AEC ($3.4 billion).[20] Thus, the additional procurement for non-covered civilian agencies for fiscal 1974 would have been something less than $6.8 billion, as compared to $45.8 billion for DOD and the $7.4 billion total for NASA, GSA and AEC. Fiscal 1974 procurement for other covered agencies (included in the $6.8 billion) was $267.2 million for the Maritime Administration (in the Department of Commerce) [21] and $268.1 million for the Federal Aviation Administration (in the Department of Transportation).[22]

Staff Recommendation and Reasons

While arguments can be made for the extension of renegotiation coverage to other agencies, the staff believes that the Renegotiation Board should at this time concentrate on improving its review of Government contracts under existing agency coverage. The staff therefore recommends retaining existing law coverage at the present time, but that this be reconsidered after the Board has time to adapt to proposed changes and has had an opportunity to operate under them for a period of time. In addition, since the Atomic Energy Commission has been reorganized and divided between the Nuclear Regulatory Commission and the Energy Research and Development Administration, the staff suggests that the statute be amended to reflect the reorganization by specifically listing the two new successor agencies.

Whenever the Congress further reviews the subject of agency coverage, it could include a specific evaluation of whether the existing nondefense agencies covered by the Renegotiation Act should continue to be covered.

C. STATUTORY FACTORS

The principal issues concerning the statutory factors are:

(2) The need to clarify the application of the existing statutory factors which must be considered in determining what constitutes "excessive profits;" and

(3) The need to revise the existing factors and/or provide additional factors to be considered in determining "excessive profits."

(2) Whether "excessive profits" can be legislatively defined.

Present Law

There are at present six specific statutory factors listed in the law (sec. 103(e) of the Act), which the Board is required to consider in

[20] General Services Administration, Office of Finance, "Procurement by Civilian Executive Agencies, Period July 1, 1973–June 30, 1974."

[21] This includes $236.5 million for ship construction subsidies, which actually are awarded by the Maritime Subsidy Board (successor in part to the Federal Maritime Board, except for the FMB's regulatory responsibilities now administered by the Federal Maritime Commission); the $236.5 million, however, is not included in the GSA report on civilian agency procurement for the Department of Commerce. In addition, the $267.2 million does not include $257.9 million paid out in "Operating Differential Subsidies" by the Maritime Subsidy Board in fiscal 1974. (Maritime Administration, Office of Budget and Program Analysis.)

[22] Federal Aviation Administration, Office of Budget.

making a determination as to whether excessive profits do or do not exist in any specific case. The first factor, "efficiency," is included in the preamble of section 103(e), which states that this factor must be given "favorable consideration," while the remaining factors are to be "taken into consideration." A seventh general "factor" is in the nature of a discretionary "other factor," giving the Board authority to promulgate, by regulation, other criteria which it deems to be in the public interest (which authority the Board has not yet utilized).

With respect to the application of the statutory factors, the Board's regulations provide that reasonable profits are to be determined by an overall evaluation of the particular factors and not by application of any fixed formula relating to rate of profit or otherwise.[1] Further, the regulations provide that renegotiation proceedings will not result in a profit based on the principle of a percentage of cost. The regulations also provide that characteristics inherent in the operation of a small company, if shown to be relevant in a particular case, are taken into consideration by the Board in applying the statutory factors.[2] Although renegotiation is generally conducted with respect to aggregate business for a contractor's fiscal year, the regulations also provide that special consideration will be given to cost-plus-a-fixed-fee contracts, other cost-type contracts and other contracts containing incentive or price modification provisions.[3] Another general provision is that prior year settlements are not controlling precedents and consideration will not generally be given to profits or losses in prior years (except to the extent specifically provided under the law and regulations).[4]

The statutory factors to be considered by the Board are:

1. *Efficiency of contractor*, "with particular regard to attainment of quantity and quality production, reduction of costs, and economy in the use of materials, facilities and manpower."

This particular statutory factor is set apart from the other statutory factors in the preamble in section 103(e) of the Act. This factor seems to be emphasized since it is set apart and the statute requires that favorable recognition "must be given" to the efficiency of a contractor. The statute and regulations provide that the other factors shall be taken into "consideration."

Under the regulations, the criteria to be taken into account are: (1) the quantity of production, including consideration of available physical facilities, meeting production schedules, expansion of facilities, and maximum use of production facilities; (2) the quality of production, including consideration of maintenance of standards, rejection record, and reported performance of the product; (3) reduction of costs; (4) economy in the use of materials, facilities, and manpower; and (5) in the case of incentive and price redeterminable contracts, differences between estimated and actual costs to the extent resulting from efficiency of the contractor.[5]

2. *Reasonableness of costs and profits*, "with particular regard to volume of production, normal earnings, and comparison of war and peacetime products."

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[1] RB Reg. § 1460.8(a).
[2] RB Reg. § 1460.8(b).
[3] RB Reg. § 1460.2(b).
[4] RB Reg. § 1460.2(d).
[5] RB Reg. § 1460.9(b).

Under the regulations, consideration of this factor is to be based, generally, on a series of comparisons. The contractor's costs and profits of the review year are compared with: (1) such contractor's costs and profits in previous years; (2) current costs and profits of other contractors, to the extent such information is available; (3) contractor and industry profits on nonrenegotiable products and services substantially similar to those products and services subject to renegotiation.[6]

Generally, losses on renegotiable business of prior years are not allowed to be used an an item of cost, with certain exceptions for carryforward of renegotiation losses for the review year.[7] However, "deficient profits" on renegotiable sales of prior years will be given consideration by the Board to the extent such deficient profits were a result of nonrecurring start-up-costs attributable to production in the review year.[8] In addition, the regulations permit a contractor to enter into special accounting agreements with the Board under which special circumstances may be recognized for purposes of reporting renegotiable profits.[9] (For further discussion of these provisions, see the section of this report relating to "Averaging of Profits.")

Under the regulations, favorable consideration will be given to increased volume of production for defense purposes to the extent the increase resulted from such factors as added risk, added capital investment, and developmental contributions. However, if volume increased as a result of Government demand without exceptional contractor effort, and without corresponding cost increases, the regulations provide that the Government should normally get the principal benefit "in more favorable prices or in renegotiation." [10]

3. *Net worth*, "with particular regard to the amount and source of public and private capital employed." Under the regulations, the relationship of profit realized on renegotiable business to the capital and net worth employed in such business is used as one of the considerations in the final determination of what constitutes excessive profits.[11] More favorable consideration is given to contractors or subcontractors who are not dependent upon Government or customer financing of any type. The regulations state that the contractor's contribution tends to become one of management only when a large part of the capital employed is supplied by others.[12]

Generally, the net worth and the capital employed are determined as of the beginning of a fiscal year, and are based on book values. If "significant" changes occur during the year, the changes will be reflected in the determination of the net worth and capital employed during the year. However, amounts arising from revaluations are disregarded.[13] For purposes of renegotiation, "capital employed" is the total of net worth, debt, and any assets furnished by the Government or customers.[14]

4. *Extent of risk assumed*, "including the risk incident to reasonable pricing policies."

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[6] RB Reg. § 1460.10(b).
[7] RB Reg. § 1460.10(b)(1).
[8] RB Reg. § 1460.10(b)(5).
[9] RB Reg. § 1459.1(b)(2).
[10] RB Reg. § 1460.10(b)(3).
[11] RB Reg. § 1460.11(b)(4).
[12] *Ibid.*
[13] RB Reg. § 1460.11(b)(1).
[14] RB Reg. § 1460.11(b)(3).

The regulations provide that while risk related to price policies is not the only risk to be considered, certainly the most emphasis appears to be focused on the pricing risk. Other risks enumerated in the regulations include: possible saturation of post-emergency markets after an industry attains maximum production during a crisis period; guaranteed delivery schedules which might prove impossible to meet because of inability to obtain materials or labor; contractors may find it difficult to meet the guaranteed level of quality of performance, especially in the case of products abnormal to the contractor's production; in diverting to defense production, commercial markets may be lost to competitors, and heavy reconversion expenses may be incurred at the end of the emergency; subcontracting, when the contractor guarantees the quality of the work, may involve more risk than production which is entirely under the contractor's control.[15] In determining degree of risk, the regulations provide that the Board is to be guided by past experience and actual loss realization under similar contracts rather than speculation on the possibility of future risk.[16]

5. *Contribution to defense effort*, "including incentive and developmental contribution and cooperation with the Government and other contractors in supplying technical assistance."

According to the regulations, the criteria to be considered in applying this factor in renegotiation are: (1) superior performance in excess of contract requirements, such as completing urgent work ahead of schedule; (2) ingenuity in providing new uses for products, machinery, or equipment; (3) overcoming difficulties others have failed to overcome in providing materials for services; (4) experimental and developmental work of high value; (5) new inventions, techniques and processes of unusual merit; (6) performance under difficult environmental or geographical conditions or hazardous working conditions; (7) cooperation with the Government and with other contractors in contributing proprietary data or in developing and supplying technical assistance to alternative or competitive sources of supply; and (8) performance, assistance or service considered otherwise exceptional.[17]

6. *Character of business*, "including source and nature of materials, complexity of manufacturing techniques, character and extent of subcontracting, and rate of turnover."

The regulations provide that the relative complexity of the manufacturing technique and integration of the manufacturing process are the basic considerations in evaluating this factor. This factor has been interpreted as offering encouragement to firms to subcontract with smaller firms "to the maximum extent practicable." [18] In this respect, any assistance in the form of management, capital or financing, labor or material given to the small business firm by the contractor would be given favorable consideration.

In addition to the above six specific factors, there is a seventh "other" factor, "the consideration of which the public interest and

[15] RB Reg. § 1460.12(b)(1).
[16] *Ibid.*
[17] RB Reg. § 1460.13(b).
[18] RB Reg. § 1460.14(b)(3)(i).

fair and equitable dealing may require, which factors shall be published in the regulations of the Board from time to time as adopted." The Board has never exercised its authority under this discretionary factor to promulgate other additional "factors" which might be used in the determination of "excessive profits."

Proposals

Previous congressionally-sponsored studies

With respect to prior studies, all three congressionally-sponsored studies recommended that clearer guidelines be established governing the application of the statutory factors which must be considered in determining what constitutes "excessive profits;" or, in other words, the crux of the entire renegotiation process.

The House Government Operations Committee Report appears to place the burden on Congress to develop and clarify existing statutory factors,[19] which have undergone little change since they were first developed during World War II. (The "statutory factors" were incorporated by Congress into the renegotiation legislation during World War II,[20] and were continued in the Renegotiation Act of 1951. The House Government Operations Committee Report also recommended that the Board submit its legislative proposals for amending the present statutory factors to provide "more objective standards for use in determining excessive profits." [21]

The Commission on Government Procurement, in recommending expansion and clarification of the criteria used in determining excessive profits, would appear to be urging both statutory change as well as clarification by the Board of the existing statutory factors.[22] The GAO charges the Board with responsibility of clarifying existing statutory factors, recommending as it does that the Board set out immediately to develop guidelines codifying its more than 20 years of experience of interpreting these factors.[23] The GAO states that:

> Since the Board lacks written guidelines for applying the statutory factors and for documenting the weight of each factor, Board officials involved with the appeal process are not aware of how subordinate officials consider the factors. Similarly, subordinate officials are not aware of how Board officials want the factors to be applied. Although it may not have been possible to obtain concensus about the guidelines when renegotiation was first adopted, we believe that, after 20 years of experience and thousands of cases, the Board should be able to do so now.[24]

In addition to the general recommendations made with respect to the statutory factors, the General Accounting Office recommended

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[19] Government Operations Report, pp. 10, 14–15.

[20] Renegotiation Act of 1942, April 28, 1942, 56 Stat. 245, as amended, 50 U.S.C. App. § 1191 et seq. (1946); 57 Stat. 347, 564 (1943), 50 U.S.C. App. § 1191 (1946); Renegotiation Act of 1943, Feb. 25, 1944, 58 Stat. (1944) 78; 50 U.S.C. App. § 1191 (1946); Renegotiation Act of 1948, May 21, 1948, 62 Stat. 259 (1948); 50 U.S.C. App. § 1193 (Supp. 1952). It was the 1943 Act amendments which provided for the first time in legislation the factors to be taken into consideration in determining excessive profits.

[21] Government Operations Report, p. 15.

[22] Commission Report, pp. 190–191.

[23] GAO Report (1973), pp. 33–41.

[24] GAO Report (1973), p. 34.

that the Renegotiation Board give greater consideration to the rate of return on capital employed in analyzing renegotiable sales, and to use industry averages to provide for more objective and broader-based analyses.[25]

In 1970, the Administrative Conference of the United States made the following recommendations:

> *1. Criteria for Determining Excessive Profits*
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> The Renegotiation Board should publish in an appropriate form specific information describing the manner in which it applies each of the statutory factors. In the case of statutory factors for which the Board applies quantitative norms, a guide or statement specifically describing those norms should be published. In the case of statutory factors for which quantitative norms are not ordinarily applied, the Board should publish complete descriptions of the specific matters it has taken into account in its application of these statutory factors and the relative importance it has given to such matters. In both cases, the information to be provided should, insofar as practicable, be categorized by industry or other relevant grouping.
>
> *2. Summaries of Facts and Reasons; Statements of Facts and Reasons*
>
> The Renegotiation Board should improve the caliber of the Summary of Facts and Reasons and the Statement of Facts and Reasons furnished to a contractor. The Summary or Statement should contain a complete analysis and explanation of the manner in which the Board arrived at its determination and should reflect the data in the Board's files upon which it has relied. This could be readily accomplished if Summaries and Statements were principally based upon the internal reports and memoranda contained in the Board's files in each case. Information concerning third parties which otherwise would be privileged or confidential upon which the Board has relied in reaching a determination should be included in a Summary or Statement of Facts and Reasons if the information can be disclosed without impairing its proprietary value or identifying its source.[26]

Renegotiation Board

In testimony before the Subcommittee on General Oversight and Renegotiation on July 29, 1975, Chairman Holmquist indicated that the Board, after having thoroughly reviewed all the issues involved, has come to the conclusion that no substantial changes should be made in the language of the statutory factors.[27] Furthermore, the Board feels that the language of the factors is essentially sound; and that it reflects all the proper considerations that should play a role in the determination of whether excessive profits are, or are not, present in a given case. Rather than propose major changes in this section of

[25] GAO Report (1973), p. 41.
[26] Administrative Conference of the United States, *Report*, June 1970.
[27] Hearings before the Subcommittee on General Oversight and Renegotiation of the Committee on Banking, Currency and Housing, House of Representatives, 94th Cong., 1st sess., July 29, 1975, pp. 310–11.

the Act, the Board believes that a concerted effort to improve its application of the statutory factors in each renegotiation proceeding will prove to be more equitable and practical. To this end, Chairman Holmquist indicated that the Board is endeavoring to provide contractors with more meaningful opinions during the entire renegotiation process in portraying the results of the Board's evaluations under the statutory factors.[28] The Board recommends that a technical change be made in section 103(e)(1) of the Act to substitute the words "renegotiable and nonrenegotiable products and services" for the words "war and peacetime products."

In 1974, the Renegotiation Board made the following recommendations to the House Committee on Ways and Means:[29]

(1) Place the "efficiency" factor (now in the preamble) as the first factor listed (so that it would be "on the same basis" as the other listed factors to avoid putting undue emphasis on the "efficiency" factor).

(2) Reposition the fifth factor, "character of business," as the new second factor (and renumber other factors accordingly).

(3) Change the language of the "reasonableness of costs and profits" factor by substituting the phrase "renegotiable and nonrenegotiable products and services" for the present phrase "war and peacetime products."

(4) Reword the "risk" factor to emphasize that pricing risk is not the only risk considered by stating "including, *but not limited to*, the risk incident to reasonable pricing policies." (Emphasis on words recommended to be added by the Board.)

Industry representatives

In general, the consensus of industry opinion in comments received by the Joint Committee staff appears to be that there should be no significant changes in the statutory factors, but that the Board should clarify how the existing factors are applied by amending the regulations or issuing written guidelines. These commentators felt that greater objectivity in determining excessive profits was desirable and that the issuance of written guidelines would result in greater objectivity in the renegotiation process. However, concern was expressed that the application of more objective standards might lead to an inflexible formula approach under which contractors would be penalized for efficiency.

In addition, one respondent recommended that the Board take contract negotiating policies into account in reaching its determinations, e.g., the weighted guidelines used by the contracting officer in negotiating a contract under the Armed Services Procurement Regulations (ASPR).[30] It was also suggested that the Department of Defense profit negotiation policies can provide an analytical framework and criteria for evaluation of the statutory factors.

Another industry representative proposed that provision be made for a plow-back offset to the extent funds are employed by a contractor to conduct reconversion and planning, undertake new commercial

[28] *Ibid.*

[29] Hearings before the Committee on Ways and Means, House of Representatives, 93d Cong. 2d sess., May 14, 1974.

[30] See ASPR § 3–808.2, relating to weighted guidelines method, and ASPR § 3–1000 et seq., relating to contractor's weighted average share in cost risk.

product research and development, or conduct market surveys on products not connected with Government work.

(Suggestions to the effect that the Board should take into consideration "deficient profits" for fiscal years preceding or succeeding the review year are discussed later in this report in connection with "Averaging of Profits.")

Staff Analysis of Proposals

General

It appears that there is little support for a formula approach which might provide an objective solution to the problem of determining excessive profits. It is argued that a formula approach would be unfair and would penalize efficiency.[31] Thus, the issues relating to the statutory factors could be resolved by clarifying the statutory factors by legislation or by clarifying the manner in which the factors are applied.

As has been indicated, all three congressionally-sponsored studies are in agreement that the statutory factors and the regulations in their present form need considerable clarification. The point is made that the statutory factors have changed little since they were originally developed by the Price Adjustment Board during World War II. Because the factors were developed in wartime conditions to apply to the widest possible range of industries and circumstances, the factors are broad in design and open to a number of interpretations. In applying them in individual cases, the Board over the years has obviously had to interpret them and, in the absence of any congressional indication of priorities, has, it is argued, given different weight or value to each of the factors as it saw fit from case to case.

Perhaps the most concise and most often cited expression of the Board's attitude in the past is the following statement taken from the Board's *Annual Report* to Congress for the fiscal year 1967:

> It is apparent from the statutory language that no formulae or preestablished rates can be used to determine whether the profits are, or are not, excessive in any given case. Rather, the determination in each instance must reflect the judgment of the Board on the application of each of the statutory factors * * * to the facts of the specific case.[32]

Now, after 24 years of experience with the Renegotiation Act of 1951, there seems to be a growing consensus that the time has come for the Renegotiation Board and the Congress to reexamine the present statutory factors in an effort to determine whether new or additional factors might not be necessary at this date, and for the Board to publish in appropriate form "complete descriptions of the specific matters it has taken into account in its application of these statutory factors and the relative importance it has given to such matters." [33]

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[31] Under the Vinson-Trammel Act of 1934 (10 U.S.C. 2382), an "excess profit" on the manufacture of an aircraft was the amount of profit in excess of 12 percent of the contract price. Under section 102(e) of the Renegotiation Act of 1951, this provision was suspended with respect to contracts which are (or would be but for certain exemptions) subject to renegotiation. Prior to amendment in 1970, profits for the construction of certain subsidized vessels were considered excessive under the Merchant Marine Act of 1936 (46 U.S.C. 1155) if they exceeded 10 percent of the total contract price. This provision was also suspended by the Renegotiation Act of 1951 for contracts subject to renegotiation.

[32] Renegotiation Board, *Annual Report* (1967), p. 3.

[33] Recommendations No. 22 of the Administrative Conference of the United States (June 1970).

The consensus of the three previously-mentioned studies is that at the moment the statutory factors and the regulations governing their application provide inadequate guidelines for firms under the jurisdiction of the Renegotiation Board or, for that matter, to the Board's staff or the Board itself in screening or renegotiating cases. In the days when renegotiation was expected to be limited to the duration of the Korean War, a disinclination to spend valuable time formulating precedents and codifying determinations might have been understandable. However, since renegotiation has continued in periods of relative peacetime it seems that the absence of formal administrative practices and procedures has become a major source of concern to every organization which has examined the renegotiation process in recent years. This concern has evidently been heightened by certain proposals which would have the effect of expanding the authority and scope of the Renegotiation Board to cover all Government contracts, eliminate some of the existing statutory exemptions or permit product line renegotiation in cases of conglomerate operations. If any or all of these proposals were to be adopted, they would result in a heavier Board workload and potentially more refunds for the Government. The absence of written guidelines, it is argued, then would likely be even more critically felt than at present.

In its examination of the Board's case files, the Joint Committee staff found that comprehensive and detailed information was usually developed in connection with a case where renegotiation proceedings were undertaken. During the course of the proceedings by the Board, the contractor is furnished copies of an accounting report, a renegotiation report, and contract performance information obtained from the contracting agency (or prime contractor in the case of a subcontractor). These reports set forth relevant financial and accounting information, an analysis of the case under the statutory factors, and an evaluation of performance.[34] In addition, the contractor will usually be made aware of the issues in which the Board is interested by the "Notice of Points for Presentation," which is sent to the contractor to enable him to prepare for a meeting with the Board.[35] Although the Board furnishes all of these reports and notices, the contractor may not be able to adequately relate the report's findings and evaluation to the final determination reached by the Board. In many of the memoranda of decisions (now called Opinions) reviewed by the Joint Committee staff, the Board indicated that the contractor was highly efficient, was engaged in a complex manufacturing operation, incurred certain risks, contributed to the defense effort in a certain manner; and yet the Board found excessive profits. In other words, there seemed to be very little verifiable correlation between these findings and the final determination, except that the findings were somehow "taken into account." In many cases, the emphasis seemed to be placed on the statistical data set forth in the Memorandum of Decision (or Opinion), such as return on sales, net worth and capital, although the amount of excessive profits determined was not clearly correlated to this data.

Even if a particular contractor may have a reasonable idea of the principal considerations involved in his case because he has received copies of the accounting, renegotiation and performance reports, the

[34] See RB Reg. §§ 1472.3(e), 1472.3(e), 1472.3(i), and 1472.7, respectively.
[35] RB Reg. § 1472.5.

Memorandum of Decision (or Opinion) would provide little, if any, guidance to another contractor in the same line of business except that in a particular case a competitor was left with a certain rate of return on sales, net worth or capital.

Section 105 of the Act provides, in part, that—

> Whenever the Board makes a determination with respect to the amount of excessive profits, and such determination is made by order, it shall, at the request of the contractor or subcontractor, as the case may be, prepare and furnish such contractor or subcontractor with a statement of such determination, of the facts used as a basis therefor, and of its reasons for such determination.

Under this provision, the regulations provide that the statement given to the contractor will contain (1) an indication of the recognition given to the contractor under the statutory factor of efficiency, (2) a separate discussion of each of the other statutory factors, (3) a discussion of each unresolved material issue of law or accounting, and (4) a basis upon which to evaluate the determination and to decide whether to litigate the case.[36] In 1974, the Board revised its regulations to provide for the issuance of "proposed" and "final" opinions and regional board opinions in clearance and agreement cases, as well as cases in which a unilateral order was to be issued. According to the Board's 1974 *Annual Report*, the regulations were rewritten in an endeavor to provide contractors and the public with more information regarding the basis for findings and determinations in renegotiation proceedings. However, in a case decided *after* these changes were adopted, the Board disposed of the efficiency factor with one sentence to the effect that the contractor was considered efficient because delivery schedules were met with a quality product. This Opinion sheds no further light as to how the efficiency factor influenced the final determination made by the Board.

It is argued that the most appropriate means of achieving clarification of the statutory factors would be by placing the burden upon the Board to issue written guidelines concerning the application of the existing factors rather than by attempting to legislatively prescribe a more precise definition of "excessive profits." It is noted by many that it is difficult to formulate a prescribed set of standards to determine the reasonableness of a profit return. It is pointed out that the standards should be both specific enough to be implemented and general enough to take into account the varieties and multiplicity of situations to which they would apply. Further, it is argued that the application of statutory factors in determining excessive profits, in view of the attendant facts and circumstances, will essentially involve a process of economic evaluation and comparison. With respect to evaluation, various ratios may be developed to determine a firm's financial position and profitability, e.g., ratios which relate net income to sales, and net income to stockholders' equity or assets, and the like. Other ratios may be used to measure the firm's efficiency in the use of assets, e.g., inventory turnover ratios.

[36] RB Reg. § 1477.4.

After an economic analysis is conducted, comparisons are necessary to evaluate the results of the analysis. The firm could be compared with other firms in the same type of business or with similar product lines, and with other firms of the same relative size. The results of the analysis for a given year could be compared with financial analyses for other years. These comparisons, indicative of the relative position of the firm, could provide a basis for an overall judgment of the firm.

The renegotiation process, it is said, appears to involve procedures similar to those employed in analyzing a firm's economic position and the results of its operations for investment purposes. In other words, various analytical ratios could be developed, including those necessitated by the peculiar nature of defense work, and then various relevant comparisons made. The result of this analysis would be an indication of the extent to which the profits of the business were substantially above what may be considered as a reasonable, competitive norm.

Consideration of net worth and capital employed

Some maintain that comparisons of rates of return on the "capital" or "assets" employed might be more meaningful than comparisons of the rates of return on "net worth." In the latter case, the net worth base would be affected by a contractor's decision to finance operations by borrowing rather than by equity investment. Although the rate of return on net worth may be especially important to the owners of a firm, this rate of return may not be indicative of the "reasonableness" of profits when leveraging is employed. Thus, the rate of return on net worth could be substantially different for two firms which are comparable as to the type of business and sales volume but which have substantially dissimilar debt/equity structures. Comparisons of rates of return on net worth or capital employed also may be made more difficult where the firm under consideration leases a significant portion of its operating assets, or subcontracts a significant portion of its work, and other firms in the same line of business do not.

Concern has been expressed regarding the manner in which the net worth and capital employed factor is applied by the Renegotiation Board in various types of situations. The General Accounting Office noted that the application of the statutory factors has provoked criticism that the Board arbitrarily leaves contractors with widely varying rates of return on capital employed.[37] The GAO further pointed out that the Board's determinations have resulted in remarkably consistent returns on sales in contrast to the wide range of returns on capital. The GAO surmised that the Board may be emphasizing the rate of return on sales rather than rate of return on capital employed as the measure of a contractor's profitability.

The GAO's 1973 report endorsed the Renegotiation Board's effort to obtain capital-employed data from contractors. The GAO urged the Renegotiation Board to issue guidelines to contractors for measuring capital employed and to develop the analytical framework and criteria for relating the capital-employed factor to renegotiable business.

In the 1973 Senate debate relating to the extension of the Renegotiation Act, Senator Proxmire indicated that, even after excessive profits were eliminated, "a number of firms were allowed to retain profits which appear to be exorbitant and unconscionable."[38] He further

[37] GAO Report (1973), p. 35.
[38] *Congressional Record*, S12605 (June 30, 1973).

noted that "of the 131 firms against whom excess profit determinations were made, the after-refund profits of 94 firms exceeded 50 percent of net worth, 49 firms made over 100 percent of net worth, 22 firms made over 200 percent of net worth, and 4 defense firms made over 500 percent profit on net worth." [39]

In presenting data with respect to excessive profits determinations for fiscal year 1973, the Renegotiation Board noted that, because of the unique nature of Government procurement, the profit results from defense contracts can be unlike the results arising from commercial transactions.[40] The Board further cautioned that the data with respect to capital and net worth return rates are not appropriate for the purposes of drawing general conclusions. The Board maintained that such conclusions could only be misleading.

Another consideration involved is that comparability of rates of return on net worth may be affected by a firm's accounting practices, its asset replacement and depreciation practices, as well as its financial structure and its use of subcontractors, leased assets and customer-furnished assets. In *North American Aviation, Inc.* v. *Renegotiation Board*,[41] the Tax Court determined that the contractor's book net worth did not reflect the true value of the assets used in the business. Accordingly, an adjustment was made by the court to reflect the value of manufacturing "know-how" for purposes of determining the reasonableness of the rate of return on net worth. Also, in *Boeing Company v. Renegotiation Board*,[42] the Tax Court indicated that no adjustment was made to book net worth to reflect current market value because there was no comparative criteria in the record on which to base such an adjustment to net worth. However, the court did adjust book net worth to reflect the value of "know-how" for purposes of determining whether the rate of return on net worth was reasonable.

A matter related to this issue is the concept of current value accounting. The Cost Accounting Standards Board has requested interested parties to furnish it with reports of competent research concerning current value accounting.[43] Currently, the Cost Accounting Standards Board is studying accounting for the impact of inflation. The Cost Accounting Standards Board said that it believes that explicit recognition of the impact of inflation on contract costs should be given priority attention.[44] The Cost Accounting Standards Board noted that many accountants today support the belief that, in periods of continuing inflation or deflation, the reliance on historical cost in the preparation of financial statements can be misleading. It further indicated that considerable research has been done on the theory of "real" business income and that it is interested in all aspects of measurement of cost of contractual performance, including concepts of measurement on the basis of current value or price level accounting.

Staff Recommendations and Reasons

Based upon conclusions that the existing statutory factors are generally appropriate for consideration by the Board in determining

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[39] *Ibid.*
[40] The Renegotiation Board, *Eighteenth Annual Report* (1973), p. 21.
[41] 39 T.C. 207 (1962).
[42] 37 T.C. 613, 643 (1962).
[43] Cost Accounting Standards Board, *Progress Report to the Congress, 1973* (Washington, D.C., 1973), p. 71.
[44] Cost Accounting Standards Board, *Progress Report to the Congress, 1975* (Washington, D.C., 1975), p. 11.

whether a contractor had realized excessive profits, and that the principal problem under present law concerns the application of the existing factors in the renegotiation process, the staff recommends that—

(1) The Board be directed to issue written guidelines describing in detail the principles which will be employed in applying the statutory factors. Before final adoption and implementation, however, the Board's proposed guidelines should be submitted to Congress not later than June 30, 1976, in order to permit consideration of the need for further legislation prior to their adoption. Further, the Board should be directed to include guidelines in further elaboration of the manner in which the special problems of small business will be taken into account and the manner and extent to which an agency's negotiating policies, including the "weighted guidelines" used for pricing purposes, will be taken into account.

(2) The "reasonableness of costs and profits" factor be amended to provide that, in determining excessive profits for a fiscal year, the profitability of the preceding three fiscal years and the next succeeding fiscal year be considered by the Board. (See also discussion of this issue under "Averaging of Profits.")

(Under present law, the Board considers "deficient" profits for prior fiscal years in a limited number of situations. This modification of the statutory factor would enable the Board to alleviate inequities which arise from fiscal year renegotiation in a wider range of situations.)

(3) The so-called "net worth" factor under section 103(e)(2) of the Act be revised by striking out "net worth" and referring only to "capital employed."

(4) A technical language change is recommended to change the phrase "war and peacetime products" to "renegotiable and nonrenegotiable products and services."

D. ACCOUNTING STANDARDS

The principal issues relating to accounting standards for renegotiation are:

(1) Whether the basic accounting standards for reporting renegotiable profits should be in accordance with tax accounting rules, the Armed Services Procurement Regulations, or generally accepted accounting principles; and

(2) Whether the allocation of costs to renegotiable business should be subject to all the rules promulgated by the Cost Accounting Standards Board.

Present law

For purposes of determining profits derived from renegotiable contracts, the Renegotiation Act of 1951 provides that receipts and accruals and costs shall be determined in accordance with the method of accounting employed by the contractor in keeping his records, but if no such method of accounting has been employed, or if such method of accounting does not properly reflect receipts, accruals, or costs, such items shall be determined in accordance with the method which, in the opinion of the Board, properly reflects receipts, accruals, or costs.[1]

[1] Sections 103(i) (relating to receipts or accruals) and 103(f) (relating to costs) of the Act. These provisions are similar to Sec. 446 of the Internal Revenue Code of 1954.

Section 105(a) of the Act provides that renegotiation is to be conducted "with respect to the aggregate of the amounts received or accrued during the fiscal year (or such other period as may be fixed by mutual agreement)" and "not separately with respect to amounts received or accrued under separate contracts." The fiscal year referred to in the Act is the contractor's taxable year for Federal income tax purposes.[2]

Renegotiation may be conducted on a consolidated basis with a parent corporation and its subsidiaries if all of the members of the affiliated group request renegotiation on such basis and consent to the application of the regulations prescribed by the Board with respect to renegotiation on a consolidated basis.[3] For this purpose, an "affiliated group" means a group of corporations which qualify as such under the Internal Revenue Code.

Amounts allowable as deductions and exclusions under the Internal Revenue Code (excluding taxes measured by income) are, to the extent allocable to renegotiation business, allowable as items of cost, but no cost is allowable by reason of a carryover or carryback.[4]

However, the Renegotiation Board may determine income and costs under another method of accounting as it decides if, in the opinion of the Board, the method of accounting employed by a contractor for Federal income tax purposes ("tax method") does not properly reflect income or costs and the contractor and the Board are unable to agree upon a method which does properly reflect income and costs.[5] Furthermore, the regulations provide for "special accounting agreements" in which the contractor and the Board may agree in writing on a method if the tax method is manifestly unsuitable because it does not clearly reflect them.[6] Such an agreement may change the entire method of accounting, as from cash to accrual, or may change only the treatment of particular costs or classes of costs. Also the Board will permit a contractor to adopt for renegotiation purposes the completed contract method of accounting for contracts to be performed over a period of more than one fiscal year, which, because of circumstances of performance, would require estimates of performance and allocation of income and costs that could result in material distortion in accounting on an interim basis prior to completion. Such contracts may include contracts for construction of major facilities or major units (such as a vessel or group of vessels) when the profits can best be determined upon completion.[7]

Under the regulations, when it is clear that a contractor's deductions and exclusions under the Internal Revenue Code result in allowable costs of renegotiable business which are in the aggregate either high or low on a comparative basis, this circumstance will be considered in connection with the factor of the "reasonableness of costs" of the contractor and the determination of the amount of any profit adjustment to be required of the contractor.[8]

Moreover, the regulations provide that the Board will exercise independent judgment on whether and to what extent and for what year

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[2] Sec. 103(h) of the Act.
[3] Sec. 105(a) of the Act.
[4] Sec. 103(f) of the Act.
[5] RB Reg. § 1459.1(b)(1).
[6] RB Reg. § 1459.1(b)(2).
[7] RB Reg. § 1459.1(b)(2)(b)(3)(iii).
[8] RB Reg. § 1459.1(b)(4).

items are allowable as deductions or exclusions under the Internal Revenue Code. Such judgment will be based upon an estimate of what the courts would do if the deductibility or excludability of the items were the subject of litigation.[9]

With respect to the allocation of costs, the regulations provide that, in general, the costs paid or incurred with respect to renegotiable business in the fiscal year under review will be the costs allocated to such business and such year by the contractor's established cost accounting method if that method reflects recognized accounting principles and practices.[10]

Further, if in the opinion of the Board there is no adequate or effective cost accounting method in use, or if the method employed does not properly reflect such costs because there are unjustified or improper allocations of items of cost in the accounting records or in the reports or statements filed for the purpose of renegotiation, costs will be allocated in accordance with such method as in the opinion of the Board does properly reflect such costs.[11] The regulations also provide that the fact that all receipts and accruals during a fiscal year are classifiable as renegotiable does not necessarily mean that all items of cost estimated to be deductible in that year are allocable to renegotiable business.[12]

The regulations also provide that generally, agreements for the allowance or disallowance of costs entered into by a contractor with another agency of the Government, either by specific contractual provision or by acceptance (expressed or implied) of Government regulations or policies, are not controlling with respect to recognition of such costs for renegotiation purposes.[13] Thus, the regulations provide that a cost properly disallowed in accordance with the Armed Services Procurement Regulations, in connection with a contract to which such Regulations are applicable, will nevertheless be recognized for renegotiation purposes if such cost is a proper Federal income tax deduction.[14]

However, the Cost Accounting Standards Board considers the Renegotiation Board to be a relevant Federal agency and subject to the rules, regulations, and standards adopted by the Cost Accounting Standards Board. The Renegotiation Board has published regulations to reflect the application of CAS Board rules.[15]

Section XV of the Armed Services Procurement Regulations (ASPR) provides rules relating to contract cost principles and procedures. These principles and procedures are applicable to the pricing of contracts and contract modifications whenever cost analysis is performed and for the determination, negotiation, or allowances of costs when such action is required by a contract clause.[16] With respect to the allowability of costs, the Armed Services Procurement Regulations provide that costs are not allowable if they result from the application of a practice which is inconsistent with the rules, regulations and standards of the Cost Accounting Standards Board.[17] With respect to

[9] *Ibid.*
[10] RB Reg. § 1459.1(b)(3).
[11] *Ibid.*
[12] *Ibid.*
[13] RB Reg. § 1459.1(b)(5).
[14] *Ibid.*
[15] 39 Fed. Reg. 44450—52 (1974).
[16] ASPR sec. 15–000.
[17] ASPR sec. 15–201.2.

methods of allocation of indirect costs, the Armed Services Procurement Regulations provide that the method must be in accordance with standards promulgated by the Cost Accounting Standards Board, if applicable to the contract.[18]

The Cost Accounting Standards Board was created as an agent of the Congress in August 1970 by an amendment to the Defense Production Act of 1950. Public Law 91–379 gave the Cost Accounting Standards Board the responsibility of issuing Cost Accounting Standards to be used by relevant Federal agencies, defense contractors and subcontractors in connection with national defense prime contracts and subcontracts in excess of $100,000. That law exempts from CAS Board promulgation negotiated defense contracts where the price negotiated is based on (1) established catalog or market prices of commercial items sold in substantial quantities to the general public, or (2) prices which are set by law or regulation.[19] The Cost Accounting Standards Board has, after considering the results of its exemption threshhold study, established an exemption for companies having no negotiated defense contracts or subcontracts in excess of $500,000.[20]

In its 1975 *Progress Report to the Congress*,[21] the Cost Accounting Standards Board reported that it had promulgated ten standards: (1) consistency in estimating, accumulating, and reporting costs, (2) consistency in allocating costs incurred for the same purpose, (3) allocation of home office expenses to segments, (4) capitalization of tangible assets, (5) accounting for unallowable costs, (6) cost accounting period, (7) use of standard costs for direct material and direct labor, (8) accounting for costs of compensated personal absence, (9) depreciation of tangible capital assets, and (10) accounting for acquisition costs of material. Recently, the Cost Accounting Standards Board promulgated a standard dealing with the composition and measurement of pension costs.[22] In addition, the CAS Board indicated that it had in various stages of research and development potential Standards dealing with 14 subjects.

Proposals

Previous congressionally-sponsored studies

The House Committee on Government Operations recommended that the annual reports of contractor costs and profits used in renegotiation should be based on the same standards as used in the pricing of defense contracts.[23]

Renegotiation Board

The Board does not presently recommend any change in the accounting standards according to the testimony given by Chairman Holmquist before the House Subcommittee on General Oversight and Renegotiation on July 29, 1975.

Industry representatives

In response to a request for comments by the Joint Committee staff, industry representatives recommended the continued application of

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[18] ASPR sec. 15–203(d).
[19] Cost Accounting Standards Board *Progress Report to the Congress, 1975* (Washington, D.C., 1975), p. 14.
[20] *Ibid.*
[21] *Ibid.*, p. 1.
[22] 40 Fed. Reg. 43873–80 (September 24, 1975).
[23] Government Operations Report, pp. 19–20.

tax accounting standards for renogotiation purposes. In addition, several respondents recommended that there should be an exemption from the Cost Accounting Standards Board rules for, purposes of renegotiation.

Other proposals

Some have suggested application of ASPR rules as the appropriate accounting standards. In addition, a Government procurement official has recommended eliminating the percentage-of-completion accounting method.

Staff Analysis of Proposals

1. Allowability

A threshold issue arises because of the basic differences in approach between renegotiation and procurement. Generally, renegotiation is conducted on a fiscal year basis with respect to the aggregate amount of a contractor's renegotiable business. On the other hand, the procurement cost standards generally focus upon allowable and allocable costs under individual contracts.

There are also differences in the rules governing "allowability" of costs. The Armed Services Procurement Regulations govern allowable costs under negotiated defense contracts, while Internal Revenue Service standards currently govern allowable costs for renegotiable business. Costs generally allowed by the Renegotiation Board but not under the Armed Services Procurement Regulations include charitable contributions, entertainment expenses, certain interest and financial costs, and organization costs.[24] Section 1459.1(b)(5) of the Renegotiation Board Regulations provides that a cost properly disallowed in accordance with the Armed Services Procurement Regulation will nevertheless be recognized for renegotiation purposes if the cost is a proper Federal income tax deduction. Similarly, an item allowable for procurement purposes will be disallowed for renegotiation purposes if it is not a proper Federal income tax deduction.

The Commitee on Government Operations indicated that the Internal Revenue Service rules are inappropriate for renegotiation purposes.[25] The Committee pointed out that, under tax accounting rules, all overhead-type expenses are considered costs of doing business and allowable as deductions if they are ordinary and necessary expenses. However, the Committee noted that overhead expenses would not necessarily constitute appropriate costs for a defense procurement contract if the expenses are not directly related to the actual performance of the contract or not attributable to a particular division performing the contract. The Committee concluded that, in view of the fact that the purpose of renegotiation is to eliminate excessive profits on defense contracts, it seemed inconsistent to apply Internal Revenue Service rules in the determination of allowable costs rather than defense contract cost standards.

In 1971, the Chairman of the Renegotiation Board indicated that the Board disagreed with a recommendation that, with respect to the

[24] ASPR §§ 15–205.8, 15–205.11, 15–205.17, and 15–205.23, respectively. Special rules relating to contributions, entertainment expenses, and interest expenses have been issued by the Renegotiation Board. Reg. §§ 1459.8(b), 1499.2–5, 1459.6, respectively.

[25] Government Operations Report, p. 5—citing Comptroller General of the United States. *Report on the Feasibility of Applying Uniform Cost-Accounting Standards to Negotiated Defense Contracts* (Washington, D.C., U.S. General Accounting Office, 1970).

allowability of costs, the more restrictive standards of procurement should be applied in renegotiation.[26] The Chairman noted that, in procurement, only costs which relate directly or indirectly to a particular contract are allowed as charges against that contract. He stated that, in renegotiation, the costs generally allowed are the proper costs of a going business, to the extent they are allocable to renegotiable business. This position was based on the premise that renegotiation is concerned with the aggregate renegotiable profits of a contractor in a fiscal year. He therefore suggested that the present statutory basis for the allowance of costs in renegotiation is equitable and appropriate, and should not be replaced. He indicated further that the use of the existing basis would be aided and facilitated by uniform cost accounting standards when promulgated. The Chairman also pointed out that the first renegotiation act in 1942 provided for contract-by-contract renegotiation but that it was amended shortly afterward to provide for renegotiation on an over-all, fiscal-year basis because of the administrative problems and to enable contractors to offset profits on some contracts by losses sustained on others.

There are many practical reasons why tax accounting standards are preferable to the ASPR rules for purposes of renegotiation. The principal reason is that both renegotiation and tax reporting are generally on the basis of a fiscal year accounting period whereas the ASPR rules necessarily relate to a contract-by-contract approach. Thus, reporting for renegotiation purposes is reconciliable to tax reporting. Moreover, the ASPR rules primarily relate to negotiated contracts whereas renegotiable business would include certain competitively bid contracts as well as most negotiated contracts.

Because of its staffing limitations, the Renegotiation Board does not generally conduct detailed examinations of a contractor's books of account. In effect, the Renegotiation Board "reviews" the contractor's segregation of sales and the composition and allocation of costs incurred with respect to renegotiable business. However, the Board does rely heavily upon audits by the Internal Revenue Service to verify the correctness of sales and tax allowable costs. Generally, almost all of the contractors subject to renegotiation might be subject to an examination by the Internal Revenue Service at one time or another. This audit backup might not be as extensive if the ASPR accounting rules were applicable to renegotiation. For example, the Defense Contract Audit Agency is essentially interested in examining books of account with respect to negotiated contracts and generally is not concerned with sales segregation, costs allocable to nonrenegotiated contracts, or profits (all of which must be considered in the renegotiation process).

In the view of many, there can be no justification for allocating tax deductible charitable contributions or the expenses of advertising in commercial periodicals as a cost of performing a Government contract when such costs are not allowable for pricing purposes under a negotiated contract subject to ASPR. However, the Board is not without authority to require appropriate changes if the tax method does not clearly reflect income.

Many of the same practical problems mentioned above would apply to adoption of generally accepted accounting principles for renegoti-

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[26] *Hearing Before a Subcommittee of the Committee on Government Operations*, 92d Cong., 1st Sess., pt. 2, at 39 (1971).

ation purposes. Moreover, the rules relating to financial accounting are not as extensive as tax accounting rules, which are interpreted by regulations, rulings, and court cases. Further, even if it is theoretically desirable to adopt "generally accepted accounting principles" for renegotiation purposes, it is probable that many contractors do not retain independent public accountants to audit their books. Moreover, even if these contractors do retain independent public accountants to audit their books, the scope of the audit may be so limited that an opinion on the fairness of the financial statements would not be issued by the auditor. Thus, the Renegotiation Board could not in certain instances depend upon the accounting profession to furnish the audit back-up which is presently furnished by the Internal Revenue Service.

2. Allocability

The Cost Accounting Standards Board has stated that cost accounting standards should result in the determination of costs which are allocable to contracts and other cost objectives. The Cost Accounting Standards Board has taken the position that the use of cost accounting standards has no direct bearing on the allowability of individual items of cost which are subject to limitations or exclusions set forth in the contract or are otherwise specified by the Government or its procuring agency.[27] Thus, although a contracting agency can negotiate the "allowability" of costs, any "allocation" of those costs between covered and noncovered contracts must be governed by the standards promulgated by the Cost Accounting Standards Board. However, the CAS Board maintains that "allocation" encompasses the assignment of costs to periods as well as to contracts. Thus, there exists some potential for conflict between the rules of the Internal Revenue Code relating to "allowability" and the Cost Accounting Standards Board rules relating to "allocability."

Presently, there appears to be some conflict between the CAS Board rules and tax accounting rules concerning the treatment of vacation pay, depreciation of tangible assets, the allocation of material costs, and pension costs. With respect to vacation pay, the CAS Board rules essentially require accruial basis accounting. Subject to a special election, a liability for vacation pay would not be accruable for tax purposes until "all events" have occurred to fix the amount of liability, i.e., the employee is vested in a certain amount. An election is provided under section 463 of the Internal Revenue Code under which vacation pay will be allowable before all events have occurred to fix the liability. Under these special rules, the amount accruable may or may not be the same as that which would be accrued under generally accepted accounting principles.

With respect to depreciation, the CAS Board has prescribed the useful lives for computing depreciation. The amount determined under these rules will not ordinarily be equivalent to tax depreciation computed under the Asset Depreciation Range system provided under section 167 of the Internal Revenue Code. Methods acceptable for tax purposes (e.g., straight-line, declining balance) are acceptable under the CAS Board rules only if resasonable. With respect to the allocation of material costs, the CAS Board rules would permit the LIFO inventory method only if costs are assigned to specific items in inven-

[27] Cost Accounting Standards Board, *Progress Report to the Congress, 1973*, p. 54.

tory. No comparable requirement is found under the tax rules since it is not necessary to distinguish between inventories attributable to Government contracts and commercial contracts.

In addition to the above potential problems, the application of different coverage rules (CAS Board rules apply to contractors and subcontractors having negotiated defense contracts or subcontracts in excess of $500,000) might result in a contractor having some of its renegotiable business for a year subject to the CAS Board rules and some of it not subject to the CAS Board rules. This possibility could lead to severe administrative burdens upon the Renegotiation Board as well as the contractors.

Staff Recommendations and Reasons

(1) The staff recommends that the general application of tax accounting standards be continued at the present time for the purpose of determining the "allowability" of costs and expenses.

This recommendation is based primarily upon practical and administrative considerations. The staff is aware that tax accounting standards may not be entirely satisfactory for renegotiation purposes. However, in light of the body of tax laws and rules and regulations which have developed, the application of the tax accounting standards will generally provide more definitive rules and result in more uniform treatment of contractors than would be the case with the application of general accounting principles or under the Armed Services Procurement Regulations (ASPR). Moreover, it is noted that the principal focus of the ASPR rules is related to pricing on a contract-by-contract basis rather than to the aggregate fiscal year profits of a contractor. In addition, continuation of the tax accounting standards would provide some audit backup by a Government agency (the IRS) which would not otherwise be available. Moreover, the Board will continue to have authority (as under present law) to consider the effect of tax accounting under the "reasonableness of costs" statutory factor and to prescribe rules relating to the "allocation" of costs to renegotiable business, without regard to the question of "allowability" for tax accounting purposes.

(2) The staff also recommends that the Board be given the authority to prescribe regulations for selective exemption from the application of specific rules prescribed by the Cost Accounting Standards Board whenever the Renegotiation Board determines that a conflict exists between application of tax accounting standards and a cost accounting standard.

E. EXEMPTIONS

A number of the existing exemptions have been criticized on the basis that these exemptions favor certain special interest groups or are founded upon assumptions which are either invalid or have not occurred. The criticized exemptions include those for standard articles and services, competitively-bid construction contracts, new durable productive equipment, raw materials (in particular oil and gas), and certain contracts performed outside of the United States. It has also been proposed that the existing exemptions be enlarged to cover certain types of contracts.

The principal issues are whether current circumstances support either the repeal of certain existing exemptions or placing limits upon

their application, and whether there are reasonable grounds for adding new exemptions, such as for certain advertised contracts or certain repetitive fixed-price negotiated procurement.

Present Law

Section 106 of the Act provides 9 "mandatory" exemptions (plus one partial mandatory exemption), five "permissive" exemptions, and a "cost allowance" (which has the effect of an exemption for integrated producers of certain agricultural products and raw materials).

1. *Mandatory exemptions*

The mandatory exemptions are as follows (sec. 106(a)):

1. Any contract by a department with any territory, possession, or State, or any agency or political subdivision thereof, or with any foreign government or any agency thereof.

2. Any contract or subcontract for an agricultural commodity in its raw or natural state or, if the commodity is not customarily sold or has not an established market in its raw or natural state, the state in which it is customarily sold or in which it has an established market.

3. Any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined, or treated beyond the first form or state suitable for industrial use.

4. Any contract or subcontract with a common carrier for transportation or with a public utility for gas, electric energy, water, communications, or transportation, when made in either case at rates not in excess of unregulated rates of such a public utility which are substantially as favorable to users and consumers as are regulated rates.

5. Contracts or subcontracts with organizations, which are tax exempt charitable, religious, or educational institutions, where the income is not "unrelated business income."

6. Any contract which the Board determines does not have a direct and immediate connection with the national defense.[1]

7. Subcontracts directly or indirectly under contracts or subcontracts which are exempt.[2]

8. Certain receipts and accruals from contracts or subcontracts for "standard commercial articles" or "standard commercial services." (See details below.)

9. Any contract, awarded as a result of competitive bidding, for the construction of any building, structure, improvement, or facility, other than a contract for the construction of housing financed with a mortgage or mortgage insured under the provisions of title VIII of the National Housing Act.

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[1] Under the Regulations, the contracts exempted include: contracts for building maintenance and repair, for other departments, for other persons or agencies, which obligate foreign aid funds, materials for authorized resale, removal of waste materials, laundry and cleaning services, certain contracts of the Commerce Department (however, except for the Martitime Administration for years after 1956, the Act does not apply to the Commerce Department), certain GSA contracts (Public Buildings Service, National Archives and Records Service, and Federal Supply Service for store stock and direct delivery contracts of the FSS to the extent delivered to noncovered Departments), certain Corps of Engineers construction contracts (civil functions other than for named projects deemed to be related to national defense as having for part of their purposes the increase of power facilities for defense), military exchanges and similar organizations using nonappropriated funds, and contracts for maintenance dredging. (The Board may also consider requests for specific contract exemptions under this provision as well as contracts let for natural disasters or other emergency repairs, etc.) (Reg. § 1453.5).

[2] Other than Contracts exempted under section 106(a)(1), (5), or (8).

In addition to the above mandatory exemptions, section 106(a) provides a "partial" mandatory exemption for receipts and accruals from contracts or subcontracts for "durable productive equipment." [3]

2. *Exemption for standard commercial articles and services*

The standard commercial article exemption provided by section 106(e) of the Act exempts amounts received or accrued in a fiscal year under any contract or subcontract for any one of the following categories: [4]

(1) A standard commercial article:

(2) A standard commercial service; [5]

(3) A service which is "reasonably comparable" with a standard commercial service; or

(4) Any article in a standard commercial class of articles.

For the exemption to be applicable to an article or service in any one of the above categories, the item must meet what may be referred to as the 55-percent rule, as well as other tests prescribed by the Act. The 55-percent rule requires that at least 55 percent of the contractor's sales of the item be nonrenegotiable during the fiscal year under review. In other words, at least 55 percent of the contractor's sales of the item must be commercial sales or sales to Government departments and agencies not covered by the Act. (The rule prior to the 1968 legislation required that at least 35 percent of the sales for the year under review be nonrenegotiable.)

Certain other tests must also be met with respect to each category. Thus, for an article to qualify as a standard commercial article it must be one which is either "customarily maintained in stock" by the contractor or is "offered for sale in accordance with a price schedule regularly maintained" by the contractor. In addition, the 1968 legislation added a provision whereby in order to qualify for the exemption the price of any such article was not to be in excess of the lowest price at which the article was sold in similar quantity for civilian industrial or commercial use, except for "any excess attributable to the cost of delivery or other significantly different circumstances."

For a service to be exempt as a standard commercial service, it must meet the 55-percent test, be a "service" as defined by the statute, and not be sold at a price in excess of the lowest price for services performed under similar circumstances for civilian, industrial or commercial work. And, for a service to be exempt as "reasonably comparable with a standard commercial service," it must be of the "same or a similar kind, performed with the same or similar materials," have "the same or a similar result * * * as a standard commercial service," as well as meeting the lowest commercial price and 55-percent tests.

For an article to be exempt as an article in a standard commercial class of articles, the class in which it is grouped must be a "standard commercial class." This means, under the statute, the class must con-

[3] This subsection exempts subcontracts and contracts (prime contracts added for years after June 30, 1953) for "new durable productive equipment" (NDPE—machinery, tools, etc. having an average useful life of more than 5 years) in the same ratio as five years bears to the average useful life of such equipment in Bulletin F (1942 edition) of IRS regulations; or if not listed there, as determined by the Board. In other words, if, for example, a piece of equipment has a useful life of 15 years, then one-third (5/15) of the receipts from the contract or subcontract would be renegotiable and two-thirds would be nonrenegotiable. (R. B. Reg. Part 1454).

[4] Except the exemption is not applicable during a "national emergency" proclaimed by the President or the Congress after the 1956 amendments. (See Sec. 106(e)(6)).

[5] The term "service" means any processing or other operation performed by chemical, electrical, physical, or mechanical methods directly on materials owned by another person. (Sec. 106(e)(4)(c)).

sist of two or more articles with respect to which five conditions are met:

(1) "at least one of such articles either is customarily maintained in stock by the contractor . . . or is offered for sale in accordance with a price schedule regularly maintained by the contractor;"

(2) "all of such articles are of the same kind and manufactured of the same or substitute materials;"

(3) the price of each of such articles is not in excess of the lowest price of articles sold in similar quantity for civilian, industrial and commercial use, except for "any excess attributable to the cost of accelerated delivery or other significantly different circumstances;"

(4) "all of such articles are sold at reasonably comparable prices;" and

(5) the sales meet the 55-percent test.

A contractor may waive the exemption (under sec. 106(e)(5)) for sales of any one or all of the categories discussed above for any fiscal year under certain prescribed conditions. In waiving the exemption with respect to any particular article or service, the contractor is not required to waive the exemption for any other article or service. The exemption for sales of a standard commercial article is "self-executing," in that it may be applied by the contractor without the filing of any application therefor, except for the proviso added in 1968 that the contractor is required to supply information to the Board if the self-applied exemption brings him under the $1,000,000 floor. However, exemptions for sales of classes of articles or services can be obtained only if the contractor files an application with the Board.

3. *Permissive exemptions*

Section 106(d) of the Act provides that the Board has discretion to exempt the following:

(1) Contracts or subcontracts "to be performed outside the territorial limits of the continental U.S. or in Alaska." [6]

(2) Certain contracts or subcontracts where the Board feels that "profits can be determined with reasonable certainty when the contract price is established"—such as for personal services, real property, perishable goods, leases and license agreements, and where the performance will not exceed 30 days.[7]

(3) Contracts or subcontracts where the Board feels the "provisions of the contract are otherwise adequate to prevent excessive profits." [8]

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[6] This exemption, as interpreted by the Board, is limited to performance by foreign nationals on foreign soil. The Regulations specify that the exemption is available if performed outside the U.S. by any person who is not engaged in a trade or business in the U.S. and is (1) an individual who is not a national of the U.S., (2) a partnership or joint venture in which individuals who are not nationals of the U.S. or corporations which are not domestic corporations are entitled to more than 50 percent of the profits, or (3) a foreign corporation more than 50 percent of the voting stock of which is owned directly or indirectly by those described in (1) and (2) (Reg. § 1455.2).

[7] The Board, however, has limited the 30-day exemption to contracts under $1,000, and has not exempted lease or license agreements. The Board has also exempted subcontracts for architectural design and engineering services and contracts entered into with a nonprofit making agency for the blind (Reg. § 1455.3).

[8] Under this provision, the Board has exempted certain operating differential subsidy contracts of the Maritime Administration, certain exploration project contracts of the Defense Minerals Exploration Administration of the Department of the Interior under delegation from the Defense Material Procurement Administration, certain prime contracts (but not subcontracts) with the Small Defense Plants Administration, and certain prime contracts (but not subcontracts) of the Small Business Administration with the covered agencies (Reg. § 1455.4).

(4) Contracts and subcontracts "the renegotiation of which would jeopardize secrecy required in the national interest." [9]

(5) Subcontracts where the Board determines it is not administratively feasible to segregate profits to activities not subject to renegotiation.[10]

4. "*Cost allowances*"

Section 106(b) of the Act provides that "in the case of a contractor or subcontractor who produces or acquires the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, and processes, refines, or treats such product to and beyond the first form or state suitable for industrial use," or one who is an integrated processor or acquirer of agricultural products, the Board by regulation is to give a "cost allowance" substantially equivalent to the amount which would have been realized if the contractor or subcontractor had sold such product in the first form or state. In other words, the integrated producer or acquirer is to be allowed, as an item of exempted cost, an equivalent amount as if he were producing and selling the raw materals exempted under Section 106(a) (2) and (3).

It has also been proposed that the existing exemptions be enlarged to cover certain types of contracts. The principal issues are whether current circumstances support either the repeal of certain existing exemptions or placing limits upon their application and whether there are reasonable grounds for adding new exemptions such as for certain advertised contracts or certain repetitive fixed-price negotiated procurement.

Proposals

Previous congressionally-sponsored studies

In its 1973 report to Congress on the operations and activities of the Renegotiation Board, the GAO recommended that the exemptions for standard commercial articles and services (SCAS) and for new durable productive equipment (NDPE) should be studied.[11] It was observed by the GAO that there was some question whether the underlying rationale for both of the exemptions was or continued to be valid. For example, the GAO noted the assumption that competition in the commercial market insures reasonable prices and profits (on sales of commercial articles and services) may not be valid in all cases. There were also indications that sales by the Government of durable productive equipment it had acquired during the Korean conflict had not in fact occurred.

The House Committee on Government Operations, in its December 1971 report,[12] recommended that elimination of all exemptions be considered, particularly the SCAS exemption since there appeared

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[9] The Board notes that a contract will be exempt only if the agency that let the contract requests that the Board not renegotiate for security reasons (Reg. § 1455.5).

[10] Under this authority, the Board grants subcontract exemptions to so-called "stock items"; that is, items sold to a contractor for his stock and which are of the type that are commingled with similar items purchased from other suppliers in such a manner that it is not administratively feasible to segregate one supplier's sales from others in order to determine the renegotiable sales attributable to the supplier. Prior to November 1, 1968, this exemption was self-applied and the exempt sales were counted as nonrenegotiable sales in calculating the then 35-percent requirement of nonrenegotiability of similar items for which the standard commercial article exemption was claimed. After this change in regulation, the Board has to grant specific approval on the application (Reg. § 1455.6).

[11] GAO Report (1973), p. 4.

[12] Government Operations Report, p. 15.

to be noncompetitive market conditions for some products which presently qualify for this exemption.

The Commission on Government Procurement, made no recommendations regarding exemptions.

Current congressional proposals

The Minish bill (H.R. 9534) proposes repeal of the exemptions for new durable productive equipment and for standard commercial articles and services. In addition, H.R. 9534 proposes that the products of an oil or gas well be eliminated from the raw materials exemption for minerals and natural deposits.

The Burton bill (H.R. 5940) proposes repeal of the exemptions for standard commercial articles and services, new durable productive equipment, and mineral products. The bill also proposes that there be eliminated the existing permissive exemption under which the Board may (in its discretion) exempt contracts or subcontracts performed outside of the continental United States or Alaska.

Renegotiation Board

In its 1975 legislative proposals (as approved by the Office of Management and Budget, the Board makes no recommendations regarding exemptions. This current position is somewhat at variance with recommendations the Board made earlier this year. Chairman Holmquist, in stating his personal views in response to a congressional request,[13] that the application of the SCAS exemption to standard commercial services, comparable services, and classes of standard commercial articles be repealed, and that the remaining exemption for standard commercial articles be modified by raising the present 55-percent qualification threshold to 65 percent, as well as eliminating the selectivity presently allowed contractors in applying the commercial article exemption (the so-called "waiver of exemption" provision). Chairman Holmquist also indicated that the NDPE exemption should be limited to apply only during times of national emergency, and that the exemption for competitively-bid construction contracts should be eliminated entirely.

The recommendations of other Board members were generally in accord with those submitted by the Board to the Office of Management and Budget on March 27, 1975. At that time, it was recommended that the exemptions for standard commercial articles and services and for competitively-bid construction contracts should be entirely eliminated, and that the new durable productive equipment exemption should be applicable only in times of national emergency. (The Renegotiation Board had previously recommended repeal of the standard commercial articles and services exemption in 1968.[14]

Industry representatives

Industry representatives, in their response to the Joint Committee staff, were almost unanimously of the opinion that none of the existing exemptions should be repealed. A majority of the industry respondents also recommended that an additional exemption be provided for advertised and competitively-bid contracts covering pur-

[13] Letter from Chairman Holmquist to the Subcommittee on General Oversight and Renegotiation, August 8, 1975.

[14] Hearings on Extension of Renegotiation Act before the House Committee on Ways and Means, 90th Cong., 2d sess., Mar. 11, 1968, p. 3.

chases of all types of goods and services where the contracts are on a cost or fixed-price basis. One industry representative suggested that the rules under the standard commercial article exemption should be liberalized to make it less difficult to apply for the exemption.

In addition, one industry respondent recommended an exemption for "repetitively-bid" negotiated fixed-price contracts; that is, contracts procured on a biannual or more frequent basis where the Government knows the costs involved because of repeated purchasing.

Other proposals

One private individual, in response to the Joint Committee staff, recommended that the raw materials exemption be repealed to prevent integrated suppliers from concealing profits in early stages of production and showing losses or low profits in the final, renegotiable, stages of production. A former member of the Renegotiation Board recommended repeal of the exemptions for competitively-bid construction contracts, new durable productive equipment, and standard commercial articles and services. Also, a Government procurement official recommended that the exemptions for new durable productive equipment and standard commercial articles and services should be repealed.

Staff analysis

General

The Renegotiation Act provides nine mandatory exemptions from renegotiation—including the exemptions for a standard commercial article or service,[15] for competitively-bid construction contracts,[16] and for raw mineral materials (including oil and gas), natural deposits, and timber.[17] Also provided are five exemptions the Board is permitted to allow, including an exemption for contracts performed outside the United States,[18] and a partial mandatory exemption for new durable productive equipment.[19] In addition, there is a cost allowance [20] for contractors or subcontractors who process raw mineral materials, na-

[15] The Revenue Act of 1943 (Public Law 235, 78th Cong., 2d Sess.) provided a permissive exemption for standard commercial articles whereby the Secretary of the Department involved could exempt contracts for such articles from renegotiation if it appeared there was sufficient competition involving the article. The Renegotiation Act of 1951 (Public Law 9, 82d Cong., 1st Sess.), however, did not include this exemption. In 1954, however, it was reintroduced as a mandatory exemption (Public Law 764, 83d Cong., 2d Sess.). In 1955, Congress added an exemption for standard commercial services (Public Law 216, 84th Cong., 1st Sess.). Public Law 870 (84th Cong., 2d Sess.) in 1956 substituted for the competitive conditions requirement a limitation whereby at least 35 percent of the sales must be nonrenegotiable if the exemption were to apply, and added an exemption for standard commercial classes of articles. The Renegotiation Amendments Act of 1968 (Public Law 90–634, 90th Cong., 2d Sess.): (1) raised the percentage test to 55 percent: (2) included a reporting requirement for those who self-apply the exemption; (3) denied the exemption if the Government is charged a higher price than that charged a commercial civilian purchaser; and (4) removed an alternative period to which the percentage test could be applied.

[16] This exemption was provided in 1955 by Public Law 216 (84th Cong., 1st Sess.). The Revenue Act of 1943 (Pub. L. 235, 78th Cong., 2d Sess.) had contained a similar exemption, but it had not been included in the Renegotiation Act of 1951 (Pub. L. 9, 82d Cong., 1st Sess.).

[17] Introduced by the Revenue Act of 1942 (Pub. L. 753, 77th Cong., 2d Sess.), and carried over into the Renegotiation Act of 1951 in the same language with the exception of a change made by the Revenue Act of 1943 (Pub. L. 235, 79th Cong., 2d Sess.) that eliminated the power of the Secretaries of the Departments of War, Navy, and of the Treasury, together with the Chairman of the Maritime Commission to define, interpret, and apply this exemption.

[18] Introduced by the Revenue Act of 1942 (Pub. L. 753, 77th Cong., 2d Sess.).

[19] Originally provided in the Renegotiation Act of 1951 (Pub. L. 9, 82d Cong., 1st Sess.), but the exemption was then limited to subcontracts. Public Law 764 (83d Cong., 2d Sess.) in 1954 extended the exemption to prime contracts and provided the definition for "durable productive equipment." Public Law 216 (84th Cong., 1st Sess.) in 1955 eliminated a requirement that equipment, to be eligible for the exemption, not become a part of an end product, or of an article incorporated in an end product.

[20] Introduced in the Revenue Act of 1943 (Pub. L. 235, 78th Cong., 2d Sess.).

tural deposits, timber, or an agricultural product beyond the first state in which it is suitable for industrial use or in which it has an established market.

The exemption for standard commercial articles was adopted on the premise that price competition was an adequate safeguard against excessive profits. This rationale was maintained in the subsequent amendments of the provision (see footnote 15, *supra*) although the emphasis was shifted from competition with other producers in the industry to price competition on an individual-contractor basis, the test being whether a certain percentage of the article or service is sold in non-renegotiable sales in the commercial market. The permission to contractors or subcontractors to waive the exemption for any article or service (without necessarily thereby waiving their exemptions as to sales of any other articles or services) was extended on the belief that this removed a burden from those who would prefer not to have the exemption rather than to incur the cost of establishing it. [21] As a result of the waiver possibility, a contractor or subcontractor may claim the exemption for high profit commercial articles or services, while not claiming it for low profit (or loss) articles or services, thereby minimizing renegotiable sales and profits.

The competitively-bid construction contract exemption is given to any contract, awarded as a result of competitive bidding, for the construction of a building, structure, improvement, or facility, other than a contract for the construction of housing, financed with a mortgage insured under the provisions of Title VIII of the National Housing Act. This exemption was apparently provided on the assumption that the existence of the competitive bidding was sufficient to protect the Government from excessive profits.[22]

Also exempted is any contract or subcontract for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which has not been processed, refined, or treated beyond the first form or state suitable for industrial use. The reason for the exemption was the belief that a renegotiator is not equipped "to deal with a vanishing asset value." [23] There were also suggestions that the exemption was justified on the grounds that the need to supply military requirements forced depleting assets to be taken out of the ground at a faster rate.[24] There was apparently also a belief that a production incentive was needed to increase the output of vitally needed materials, such as copper and steel.

The exemption for contracts performed outside the United States was adopted in view of the difficulty of asserting court jurisdiction over a foreign national operating outside the U.S.[25]

A partial mandatory exemption is allowed for certain receipts and accruals from contracts or subcontracts for new durable productive equipment. This exemption was extended to subcontractors on the

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[21] Senate Report No. 2624 (84th Cong., 2d Sess., 1956), p. 6. In retrospect this argument appears inadequate because the standard commercial article exemption is self-applied. That is, the Board's permission for exemption is not required. Therefore, no cost need be incurred in establishing the exemption. On the other hand, the Board's permission is required for the standard commercial service and standard commercial class of articles exemptions.

[22] Senate Report No. 582 (84th Cong., 1st Sess., 1955), p. 3.

[23] Hearings on Public Law 528 Before a Subcommittee of the Senate Committee on Finance (77th Cong., 2d Sess., September 29 and 30, 1942), p. 128.

[24] Hearings on H.R. 9246 Before the House Ways and Means Committee (81st Cong., 2d Sess., 1950), p. 19.

[25] A Subcommittee of the Senate Committee on Finance, "Renegotiating War Contracts" (77th Cong., 2d Sess., 1942), p. 6.

assumption that the affected industries, such as the machine tool industry, are highly cyclical, and that wartime production of such equipment was so heavy as, upon conversion to civilian use, to throw the industries into long depressions.[26] The exemption was arbitrarily limited to the receipts or accruals allocable to the first five years of the machinery's useful life on the theory that the machinery would be used approximately five years in defense production.[27] This exemption was extended to prime contracts (sales to the Government or on account of the Government) in 1954 because of increased direct sales of such equipment to the Government on its account.[28]

The Renegotiation Act permits a "cost allowance" (tantamount to a partial exemption) for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, that is processed, refined, or treated beyond the first form or state suitable for industrial use. The cost allowance is to be substantially equivalent to the amount the contractor or subcontractor would have realized had he sold the product in its first form or state suitable for industrial use. This cost allowance was enacted to given integrated miner-manufacturers and those who acquire such raw mined materials an exemption similar to the exemption (previously described) given their competitors for raw mined materials which are not processed beyond the first stage at which they are suitable for industrial use.[29]

Standard commercial articles and services

The exemption for commercial articles and services (SCAS) comprises the most heavily used of all of the exemptions, both in terms of the dollar value of the otherwise renegotiable business which is exempted and in terms of the number of exemptions applied for or self-applied by the contractors. During its 1975 fiscal year, the Board processed 381 contractor cases where contractors had applied or self-applied the SCAS exemption to a total of $778.9 million of otherwise renegotiable business. Of this total, applications for $135.3 million were denied or withdrawn by the contractors.

The underlying rationale for the SCAS exemption has been that when goods and services are sold in volume quantities in competitive commercial markets, the goods and services will have market-tested prices which in ordinary circumstances will be assumed to be fair and reasonable. With the exception of contractors and their representatives, a considerable majority of those parties who made legislative proposals concerning exemptions were of the opinion that the SCAS exemption should be either repealed or made more restrictive. The opponents of the SCAS exemption argue that either the underlying rationale for the exemption is often in actuality not valid, or that the procedural rules and conditions for applying the exemption work to distort its purpose and in some cases discriminate against contractors who lack the sophisticated techniques for segregating and categorizing sales in order to qualify for the exemption.

The procedural criticisms of the SCAS exemption relate to the considerable degree of latitude accorded the contractor under the elections to waive the SCAS exemption for any or all articles which would

[26] Senate Report No. 643 (83d Cong., 1st Sess., 1953), p. 3.
[27] Senate Report No. 92 (82d Cong., 1st Sess., 1951), p. 7.
[28] Senate Report No. 643, supra note 26, at p. 3.
[29] Senate Report No. 627 (78th Cong., 1st Sess. (1943)), p. 36.

otherwise be exempt, and to select the "commercial" items to be included in an application for exemption of a class of articles. Where the contractor uses the waiver provision, it will (unless a full application of the exemption will bring it below the $1 million floor and make all of its business nonrenegotiable) apply the exemption to eligible high-profit items and waive the exemption for other eligible items on which it had low profits or losses. The obvious result of this maneuver is to remove from renegotiation the items having the most potential for excessive profits, while reducing the average profits on these items which remain subject to renegotiation.

The assembling of a class of exempt articles provides similar advantages. Typically, the contractor with a sophisticated costing system in this situation assembles a class of commercial articles which includes articles for which a high percentage of sales are not renegotiable. The contractor also includes in the class a number of items which are renegotiable but for which the percentages of nonrenegotiable or commercial sales would prevent these articles from separately satisfying the 55-percent nonrenegotiable sales requirement. These latter sales also typically have high profits with considerable potential for excessive profit determinations. When both types of articles are combined in the one class, the class will, with careful planning by the contractor, satisfy the 55-percent requirement, which, with satisfaction of the other less difficult conditions, qualifies the entire group of contracts for the exemption. As a result, the high-profit contracts are shielded from renegotiation.

Another aspect of the class exemption which, it is argued, provides potential for abuse is the opportunity for the contractor to broadly interpret the "like kind" criteria and include in the class articles which have only a nominal similarity to the one "keystone" and true standard commercial article in the class—an article which is maintained in stock and sold under a catalog price. For example, a contractor may manufacture and sell commercially a line of pumps which it maintains in inventory and offers at catalog prices. It also may manufacture, solely for the Government, pumps which operate in the same fashion and are of the same approximate size but which are considerably more expensive because they must conform to strict Government specifications as to tolerances and quality of materials. It is likely these two types of pumps could be included in the same exempt class of articles even though there are substantial differences in the quality and durability of the two types of pumps. It has also been pointed out that the Government is the sole purchaser of some types of specialty steel and computers which are considered to be eligible for inclusion in exempt classes (along with the contractor's regular commercial steel and computers), even though the specific articles are sold only to the Government and manufactured solely to Government specifications.

Considerable criticism is also leveled against the SCAS exemption because, it is argued, the underlying assumption of market-based, competitive pricing is often invalid in actual circumstances. The situation where the competitive pricing assumption appears most tenuous is in the sole source situation, where only one contractor has the expertise or capability to provide the necessary standard commercial article or service. There are many situations where sole source procurement may effectively arise, such as in purchase of large military hardware,

data processing equipment, NASA purchases of large quantities of gaseous materials for the space program, and parts or accessories for a specialty-designed product.

It is also pointed out that Government procurement has a substantial impact upon the supply of articles and services in areas which remain generally competitive, particularly where Government demand is cyclical. These circumstances may cause demand for a product or service to exceed its supply and result in high prices. This imbalance of supply and demand in those areas of production impacted by Government procurement may, in turn, create windfall profits for contractors. The Board has noted, in a study on the impact of Government procurement, that the prices the Government paid for a particular type of goods accelerated rapidly as the production of this industry reached capacity. The price acceleration even occurred on successive orders from the same contractors despite the fact there was no indication that the contractors had experienced corresponding increases in their production costs. It should be pointed out that this study involved products with a great deal of similarity to standard commercial articles; however, the articles themselves in this case were sufficiently specialized that they did not qualify for the SCAS exemption.

One problem with examining the validity of the SCAS exemption is that the Board does not audit exemption matters. Also, the Board believes that it lacks the statutory power to audit the nonrenegotiable sector of a contractor's business, and it therefore is unable to develop adequate statistics regarding the assumption of competitive pricing in the SCAS exemption area and the extent excessive profits escape through use of the exemption. However, in two instances reviewed by the Committee staff where contractors had been granted large SCAS exemptions, the Board noted the existence of very high profit margins on many millions of exempt sales arising in what appeared to be, in essence, sole source procurement situations. In one case the contractor had a profit margin of over 40 percent on exempt sales in excess of $70 million.

There are two basic alternatives available with regard to change in the SCAS exemption, and there appears to be considerable justification offered for each alternative. The first alternative is to retain the basic SCAS exemption but to tighten its application by such measures as removing the exemption for "classes" of commercial articles and eliminating the extent of selectivity a contractor presently has through the "waiver" provision. It is also possible to raise the percentage test (for purposes of qualifying for the exemption) from 55 percent to some higher percentage. This would provide some degree of additional assurance that the Government's price is compatible with that in the commercial marketplace. As a complementary change to raising the percentage test, it could be provided that sales to noncovered Government agencies (which sales are exempt from renegotiation) be excluded from the commercial sale denominator for purposes of the percentage test. These changes in combination would eliminate much of the opportunity for abuse which presently arises through the SCAS exemption.

However, it is also indicated that there are many situations where the circumstances in the marketplace (such as the existence of a sole supplier and where Government procurement has a substantial

impact) prevent effective operation of the competitive pricing mechanism when standard commercial articles are purchased by the Government. It appears that such situations may arise frequently and result in the escape from renegotiation of sizeable amounts of potential excessive profits. Therefore, it has been concluded that the SCAS exemption should be repealed in its entirety.

Exemption for competitively-bid construction contracts

The mandatory exemption for competitively-bid construction contracts [30] has proved difficult for the Board to administer. To clarify the exemption, the Board's regulations [31] provide that contract changes exceeding one-third of the original contract price are subject to renegotiation. The present chairman of the Board has suggested that the statute could be amended to clearly allow renegotiation of any changes (in excess of some *de minimus* amount) in excess of the original contract prices.[32]

Aside from the administrative problem, however, there has been criticism of the basic exemption. The basis of the exemption is the understanding that the competition derived from competitively-bid contracts protects the Government from excessive profits. Opponents of this exemption note that other types of "competitively-bid" contracts (other than those exempted under SCAS) are not exempted from renegotiation, as other types of DOD formally-advertised contracts are covered under the Act. On the other hand, it is argued by proponents of the exemption that it is unfair, in the case of firm fixed-price contracts, to limit profits when the contractor's possible losses are not limited.

The Board's experience, however, as well as a recent study of Board excessive profits determinations made by the GAO (still in draft form) [33] indicate that many excessive profits determinations have been made in cases involving advertised, competitively-bid contracts. Among the factors that lead to this result are: strictly written specifications (such as in defining patented or proprietary products), a remote project location, the large size of the contract, urgency of demand, or few qualified bidders.

In one example reviewed by the Joint Committee staff in the course of its investigation, one company had sales of $5,051,778 under a competitively-bid construction contract. Because of the exemption $2,521,600 of this total was excluded, leaving renegotiable sales of $2,530,178. The contractor's profit on its renegotiable sales, however, was 31.3 percent of sales. Since the contractor allocated its costs on a sales ratio method, the profit on the exempt portion of its sales necessarily was also 31.3 percent. In this case, therefore, the fact that the exempt portion was under a competitively-bid construction contract did not prevent the contractor from receiving profits on that contract which most observers would regard as excessive.

In the light of this and other examples which have come to the attention of the staff, and for much the same reasons subsequently dis-

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[30] There is no exemption for the construction of housing financed with a mortgage or mortgages insured under title VIII of the National Housing Act, as amended.

[31] R.B. Reg. §§ 1453.7, 1499.1–7, and 1499.1–8.

[32] Hearings Before the Subcommittee on General Oversight and Renegotiation of the House Commitee on Banking, Currency and Housing, 94th Cong., 1st Sess (1975), p. 297.

[33] See later discussion of *"Additional exemption for advertised, competitively-bid contracts."*

cussed with regard to the question of a new exemption for advertised, competitively-bid contracts, the Government does not appear to be protected from the possibility of excessive profits by the existence of the competitive bidding.

New Durable Productive Equipment

The partial mandatory exemption for new durable productive equipment (NDPE) is applicable to both subcontracts and prime contracts. As it was originally enacted in 1951, however, the exemption applied only to subcontracts; that is, the sale of productive equipment (such as machine tools) to a higher tier subcontractor or prime contractor for use in performing a renegotiable Government contract or subcontract. The subcontractors who manufactured and sold the equipment argued that their sales of NDPE should not be renegotiable to the extent the user would eventually convert and use the equipment for production of peacetime commercial products. It was decided that the period of use of the equipment for performance of Government contracts was typically in the range of five years, and therefore a partial exemption was provided to the extent the useful life of the equipment exceeds five years. In 1954, the partial exemption was extended to sales of NDPE under prime contracts because the Government itself had purchased large quantities of equipment during the Korean conflict and the equipment manufacturers were concerned that the Government would sell such equipment after the conflict had ended and depress the private market for productive equipment.[34]

The application of the NDPE exemption has generally been restricted to machine tools and related plant equipment. During its 1975 fiscal year, the Board processed only six applications for NDPE exemptions. One of the applications was withdrawn, and the approval of the remaining five resulted in exemptions for $8.6 million of NDPE sales.

There is some question whether the NDPE exemption should be continued, and its critics argue that the original assumptions under which the exemption was enacted no longer exist.

In its 1973 report, the GAO pointed out that the assumption that the Government would dump large quantities of used productive equipment on the market after cessation of a national emergency (which caused it to acquire the equipment) has never actually occurred. Advocates of the exemption, on the other hand, point to the substantial reduction in the number and value of Government-owned productive equipment between 1968 and 1975, and suggest this is evidence that the Government did in fact sell large quantities of productive equipment during the period following the Vietnam-related military buildup. However, it seems likely that a significant portion of the reduction may have resulted from the removal of equipment from the inventory due to obsolescence and depreciation in the value of other equipment.

An anomaly also arises through the use of Schedule "F" useful lives for purposes of the NDPE exemption. Under Schedule "F" (promulgated in 1942 for purposes of tax depreciation), machine tools are accorded useful lives in the range of 17–20 years. However, under more recent announcements (such as the Rev. Proc. 62–21 guidelines and the

[34] Public Law 764, 83d Cong., 2d Sess. (1954).

Asset Depreciation Range enacted in 1971), the proper useful life for machine tools is generally considered to be approximately 9 years. It may be easily perceived that the use of the longer Schedule "F" useful life allows a greater portion of the NDPE sales to escape renegotiation than appears to be proper under contemporary rules. (The contractor who uses the equipment will also probably adopt accelerated depreciation and recover a substantial majority of their cost within the five-year exemption period.)

Finally, those favoring repeal also consider that conditions today do not cause excessive production of long-life productive equipment and create distortions in the demand for NDPE. They also argue that in modern-day conditions, Government procurement has remained at relatively stable high levels and it is consequently likely that NDPE which was purchased for Government contract work continues to be used for such purposes for periods longer than five years.

Although the amount of NDPE which escapes renegotiation is relatively small, it is argued that there is little valid justification for the exemption and therefor the exemption should be repealed. Although the Board has suggested (in its March 1975 recommendation to OMB) retaining the exemption but making it applicable only in times of declared national emergency, it would appear that it is more appropriate to repeal the exemption at this time and then consider the need to reinstate the exemption in light of the circumstances in existence at the time a national emergency arises.

Exemptions for raw mineral products and the related "cost allowance"

An exemption is provided for contracts or subcontracts for the product of a mine, oil or gas well, or other mineral or natural deposit, or timber, which is not processed, refined, or treated beyond the first form or state suitable for industrial use (sec. 106(a)(3) of the Act). For such products which are processed, etc., beyond the first form or state suitable for industrial use, a "cost allowance" is provided (Sec. 106 (b)), which is intended to be equivalent to the value of the exemption to the contractor or subcontractor had he sold the product at its first industrial form or state.

As previously indicated, the raw materials exemption was provided primarily because the problems in determining the value of assets remaining in the ground after the extraction make it difficult to calculate the value of the mined product, and hence also make it difficult to determine what profits are excessive. The cost allowance was provided to place those who refine such products to and beyond their first industrial state in the same position as is enjoyed (because of the raw products exemption) by those who sell the product without refining it past its first suitable industrial state.

More recently, suggestions have been made that the raw minerals exemption (particularly, for oil and gas) should be repealed. One reason given for this proposal has been the increasing profits assertedly enjoyed by raw mineral producers, with the correspondingly decreased need for incentives, as their mineral products have become more scarce and as competitive market pricing no longer operates due to monopolistic or oligopolistic situations arising in certain raw mineral producing sectors.

Other problems have arisen out of proper cost allocations. In the case of foreign oil producers, the nations in which the oil is produced have sometimes required an artificially high posted price for crude oil in order to protect their tax base. If this oil is sold by the producer to an affiliated corporation in this country for further resale to a refiner who sells to the Government, the cost allocable to the crude oil stage is overstated. If a cost allowance (for refining a product to and beyond its first industrial state) is involved, the cost allowance will be overstated because too much will have been allocated to the cost of the crude oil. It may be that no cost allowance is involved since the crude oil (which is at the stage of its first industrial use even before refining) is not refined both to and beyond its first suitable industrial use by the eventual refiner. Even in this case, however, the ostensible profits of the American affiliate who sells to the eventual refiner will be reduced because of the overstatement of its cost. This results in a minimization of renegotiable profits on the part of the American affiliate, which is deemed a subcontractor for purposes of renegotiation.

As to problems of this nature, it may be that elimination of the exemption is not an appropriate answer. An alternative approach the Board might consider could be along the line of a reapportionment of income and costs between the affiliated corporations. Guidelines for such reapportionments could be found in the actions of the Internal Revenue Service under section 482 of the Internal Revenue Code of 1954 (26 U.S.C. 482). The Board, in fact, now has the power to make such reallocations under its own regulations.[35]

Similar problems could arise in cases of domestic sales of a raw mineral product between domestic affiliates. If the second affiliate refines or processes the product to and beyond its first industrial use, it is entitled to a cost allowance for the amount it would have realized had it sold the product at its first industrial use. The affiliates might then both minimize taxes and maximize the cost allowance by pricing the product at an artificially high cost to the refining or processing affiliate.

In this example, the cost allowance of the refining or processing affiliate (on a renegotiable sale to the Government) might be exaggerated by the artificial allocation of costs to a stage preceding the stage of the first industrial use of the product. As to the tax effect, the United States Supreme Court has ruled that the cutoff point for the percentage depletion allowance deduction for minerals is the point at which the product first becomes suitable for industrial use or consumption.[36] Thus, the depletion allowance might be maximized, and taxes minimized, by artificially allocating costs back to the stage at which costs are eligible for the depletion allowance.

Again, the Renegotiation Board might consider the procedures the Internal Revenue Service follows under section 482 of the Internal Revenue Code to resolve similar problems. In addition, the Board might consider the regulations, rulings, and case law that has evolved from the determination of the cutoff point for purposes of percentage depletion allowances.

It may be that these allocation problems, and the other questions surrounding these exemptions, would be better dealt with by means other than an elimination of the exemptions. For that reason, the Con-

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[35] R.B. Reg. §§ 1459.1(a) and 1453.2(c).
[36] *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, 5 AFTR2d 1773 (1960).

gress may wish to consider requiring the Board to submit a study of these raw materials exemptions (and the related "cost allowance") and the problems that have arisen from them, with the study to be submitted to Congress by an appointed time.

Permissive exemption for contracts performed outside the United States

As noted earlier, the Board is permitted to exempt contracts and subcontracts to be performed outside the United States. This exemption has come under some criticism, and the Burton bill (H.R. 5940) proposes to repeal this exemption. It appears, however, that at least some of the criticism results from a misunderstanding of the application of the exemption.

The congressional intent in enacting this exemption was to allow the Board to recognize jurisdictional problems a United States court would have over foreigners operating in foreign nations.[37] However, the criticism of the provision indicates a belief that it allows domestic contractors and subcontractors to retain excessive profits simply because their contracts are performed outside the United States.

In fact, the Board has exercised its right to permit this exemption, but its regulations generally restricts the exemption to contracts and subcontracts performed outside the United States by persons not engaged in a trade or business in the United States who are also foreign nationals.[38] In cases of partnerships and corporations, at least 50 percent of the ownership must be in the hands of foreign nationals. Thus, the regulations interprets the statutory provision in the narrow sense it was intended.

The exemption for foreign nationals on foreign soil is automatic. No special application for it need be made. However, this exemption may also be allowed in cases of special application for exemption when the contract or subcontract is to be performed on foreign soil if:

(1) the contracts or subcontracts are to be placed with foreign nationals or foreign corporations whom "it is not practicable to subject to renegotiation" (although such foreign nationals or corporations may conceivably be engaged in a trade or business in the United States);

(2) the contractural provisions are deemed sufficient to prevent excessive profits;

(3) the program is important to national defense and refusal of the exemption might jeopardize the program; or

(4) the contract or contracts should be exempted "for any combination of the foregoing reasons or for any other reason."[39]

To the above extent, the Board's regulations appear to exceed the scope of the exemption as envisioned by Congress. Congress could eliminate or restrict the power of the Board to provide the exemption in cases of contracts that would clearly be subject to the jurisdiction of United States courts.

The Board's regulations extend the exemption to contracts performed outside the United States, Puerto Rico, the District of Columbia, the Canal Zone, or any Territory or possession of the United States. The statutory provision, however, would appear to give the

[37] See note 25, *supra*.
[38] R.B. Reg. § 1455.2(c–1).
[39] R.B. Reg. § 1455.2(d).

Board latitude to exempt contracts or subcontracts performed in some of these areas. Congress could amend the statutory provision to restrict the Board's power along the line indicated in the Board's regulations.

Additional exemption for advertised, competitively-bid contracts

As noted previously, a number of industry representatives have recommended an additional exemption for advertised and competitively-bid contracts which are awarded on a cost or fixed-price basis. The general rationale for these proposals is like that for the existing SCAS exemption; that is, the awarding of Government contracts on the basis of competitive bids provides the Government with the same safeguards against unreasonably high costs as is provided a commercial contractor who procures such goods or services on the basis of competitive bids. It is also argued, in the case of firm fixed-price contracts, that it is unfair to place upon the contractor the burden of absorbing a loss if its costs are higher than estimated, while limiting the profit it may retain in the event its costs are lower than estimated and it realizes a greater than anticipated profit.

As a generalization, the assumption that competitive bidding brings about fair pricing is theoretically correct. However, there are many situations in Government procurement where the market conditions surrounding a particular contractual transaction hinder effective competition and negate this generalization. The assumption of a free marketplace may be negated by the existence of a variety of factors which limit bidding. Among these factors are: strictly written specifications (such as for patented or proprietary products), a remote project location, the large size of the contract, urgency of demand, or few bidders qualified to handle the contract.

The Board has found that as a practical matter excessive profits often arise where bidding was limited, even though there was competitive bidding and the contract was for a fixed price. A recent study by the GAO (still in draft form of contracts for which the Board made excessive profit determinations during fiscal years 1970 through 1973 tends to confirm that substantial amounts of excessive profits can arise under competitively-bid contracts which are also fixed-price or cost-based contracts. Of the $5.7 billion renegotiable sales of the contractors having excessive profits determinations during this period, a sizeable majority arose under firm fixed-price contracts and more than 10 percent arose under fixed-priced incentive fee contracts. The GAO also selected a sample of contractors involved in excessive profits determinations during this period and identified the contracts which it believed to be the source of the contractor's high profits. The GAO noted that a substantial majority of the contracts in their sample were fixed-price contracts and slightly more than one-half were awarded on the basis of price competition or market/catalog prices.

Based on these considerations, there appears to be considerable justification for arguments that the existence of competitively-bid, fixed-price contracts provides the Government with little effective assurance that this procurement procedure will prevent excessive profits. The staff therefore concludes that an exemption for advertised, competitively-bid contracts should not be adopted at this time. Likewise, the staff does not recommend that an exemption be provided for repetitively-awarded negotiated fixed-price contracts.

Staff Recommendations and Reasons

For the above-mentioned reasons, the staff recommends that the following exemptions be repealed:

(1) Standard commercial articles and services;
(2) Competitively-bid construction contracts; and
(3) New durable productive equipment.

If the exemption for standard commercial articles and services is not repealed, the staff suggests that the exemption be tightened by removing the "class" exemption and the "waiver of exemption" provision, and by raising the percentage test from 55 percent to 70 or 75 percent. Also, it is suggested that the percentage test be modified to exclude sales to noncovered Government agencies as qualifying for the minimum percentage.

In addition, the staff recommends that the Board be directed to evaluate the raw materials exemptions and the related question of the "cost allowance" provision for integrated firms, and to report directly to the Congress not later than June 30, 1976.

F. CLASSIFICATION OF CONTRACTOR SALES FOR RENEGOTIATION

In summary, the principal issues are:

(1) Whether renegotiation should continue to be conducted on an aggregate basis;
(2) Whether renegotiation should be conducted on the basis of product lines, commodity groups, divisions, profit centers, etc.; and
(3) Whether renegotiation should be conducted on a contract-by-contract basis or should it be conducted on this basis only for contracts above some minimum amount.

Present Law

The Renegotiation Act provides for renegotiation on an aggregate sales basis for each fiscal year as follows (Sec. 105(a)):

> "The Board shall exercise its powers with respect to the aggregate of the amounts received or accrued during the fiscal year (or such other period as may be fixed by mutual agreement) . . ., and not separately with respect to amounts received or accrued under separate contracts . . . except that the Board may exercise such powers separately . . . under any one or more separate contracts . . . at the request of the contractor or subcontractor."

The Board interprets this provision as a requirement that it renegotiate on a fiscal year basis. Also, the regulations interpret the statute as requiring:

> "renegotiation be conducted on an over-all basis unless the contractor and the Board agree that renegotiation be conducted with respect to its contracts separately or as two or more groups. Generally, renegotiation will be conducted on the basis of the amounts received or accrued by a contractor from its renegotiable prime contracts and subcontracts for a fiscal year. Under this method, excessive profits are determined by examining the contractor's financial position and

the profits from such prime contracts and subcontracts taken as a whole for a particular fiscal year rather than on an individual contract basis. This avoids problems of allocation of costs and profits to each prime contract and subcontract, allows the contractor to offset the results of one contract against the results of another, and simplifies administration. Any other procedure may be employed only if authorized by the Board pursuant to these regulations." [1]

Section 105(a) of the Act further states that:

With respect to "related" groups, "By agreement with any contractor or subcontractor, and pursuant to regulations . . ., the Board may in its discretion conduct renegotiation on a consolidated basis in order properly to reflect excessive profits of two or more related contractors or subcontractors."

Under the regulations, the term "related group" means a group of persons in which 80 percent of stock of a corporate member of the group, or the right to 80 percent of the profits of an unincorporated member, are owned directly or indirectly by one or more of the other members of the group, or by the same person or persons other than a member or members of the group.[2]

Regarding consolidation of contractor or subcontractor sales of an affiliated group, Section 105(a) continues:

"Renegotiation shall be conducted on a consolidated basis with a parent and its subsidiary corporations which constitute an affiliated group under . . . the Internal Revenue Code if all of the corporations . . . request renegotiation on such basis and consent to such regulations . . . with respect to (1) the determination and elimination of excessive profits of such affiliated group, and (2) the determination of the amount of the excessive profits of such affiliated group allocable . . . to each corporation included in such affiliated group."

Under the regulations, the term "affiliated group" means a group of corporations which qualify as such under the Internal Revenue Code.[3]

Section 105(e)(1) of the Act provides, in part, that a contractor shall file a financial statement in such form, detail, and containing such information as the Board may prescribe by regulations. In addition, the Board may require a contractor to furnish any information, records, or data which are determined by the Board to be necessary to carry out the act. With respect to the basic annual contractor report form (RB Form 1), the instructions state that:

"If you are engaged in more than one type of renegotiable business, or if you operate on a divisional basis, schedules showing operating results by principal products, services or divisions should be submitted to supplement the information in this section, separated between renegotiable and non-renegotiable business."

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[1] RB Reg. § 1457.1(b).
[2] RB Reg. § 1464.22(b).
[3] RB Reg. § 1464.21(b)(1).

In light of the foregoing provisions, there has been some uncertainty under present law as to the manner in which the Board reviews sales and profits by product lines, commodity groups, or component units of a contractor. In response to an inquiry from Mr. Chase (a Board Member), the General Counsel of the Board indicated in a memorandum of February 22, 1974, that the Board has the authority to examine costs and profits generated by a division, single profit center, or product line of a contractor. In addition, the General Counsel indicated that, after the Board had reviewed and analyzed data on this basis, the Act required the Board to aggregate the amounts in reaching a final determination. The General Counsel based his decision on the legislative history of the Act and the logical consideration that application of some of the statutory factors on an overall basis would be virtually meaningless, e.g., character of business, risk assumed, and efficiency.

As a result of the General Counsel's memorandum, a dissenting opinion filed by Mr. Chase in the McDonnell-Douglas determination made in 1974, and a comprehensive report prepared by Mr. Houston (a Board Member) in March 1975,[4] the Board took action to clarify its position concerning this issue. On April 10, 1975, the Board adopted the following resolution:

> "The Board reaffirms its authority to require the submission of financial and performance data, including sales, costs and profits, which the contractor maintains by product lines, profit center, division, or such other segment, or category. When the Board deems it appropriate to obtain such detailed data as may be described in the regulations with respect to such varying activities, it shall apply the statutory factors separately to each different segment covered by such data. The resulting findings of excessive profits or deficient profits, as the latter will be defined in the regulations, applicable to each separate segment shall be aggregated and used, together with contractor wide factor consideration, in arriving at a final determination of whether excessive profits were realized by the contractor on its total renegotiable business.
>
> The Board by this resolution directs the staff to develop the necessary regulations to implement this policy declaration at the earliest practicable date."

Proposals

Previous congressionally-sponsored studies

The House Committee on Government Operations recommended that contractors' sales be classified according to individual commodity groups and that renegotiation be based on product lines rather than on total fiscal year sales for the company. To facilitate this, the Committee suggested that contractors should be required to report costs and profits on Government contracts over $100,000 on a contract-by-contract basis, with these cost and profit reports to be audited by the Department of Defense auditors prior to submission to the Renegotiation Board.[5]

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[4] "Product Lines and Conglomerates," A Study and Recommendation for the Renegotiation Board (Mar. 18, 1975).

[5] Government Operations Report, pp. 16–17.

In addition, the Committee suggested modifying as necessary the renegotiation process to compensate for the impact that corporate mergers and acquisitions have had on renegotiation, with consideration given to "eliminating the loopholes that allow conglomerates, through fiscal operations and overhead allocations, to frustrate or avoid the recoupment of what otherwise would constitute excessive profits under the Act." [6]

Renegotiation Board

According to the testimony given by Chairman Holmquist before the Subcommittee on General Oversight and Renegotiation on September 19, 1975, the Board does not presently recommend any changes concerning classification of contractor sales, costs and profits for renegotiation purposes.[7]

Mr. Holmquist did indicate, at the July 29, 1975, Hearing, that one of the causes for the increase in the backlog of cases is the absence of guidelines from the Board on how to analyze each contractor's report by appropriate segments or commodity groups for a given fiscal year, and then how to properly aggregate the "excessive" profits occurring in one or more components with losses or deficient profits that may be found to be present in other components. He also indicated that guidelines are being prepared to implement the Board's Resolution of April 10, 1975.[8]

Current congressional proposals

The Burton bill (H.R. 5940) would amend section 105(a) of the Act to provide that the Board, in exercising its powers, consider amounts received or accrued by division and by major product lines; and further, that the Board may consider contracts separately if deemed necessary.

The Minish bill (H.R. 9534) would amend section 105(a) of the Act to provide that the Board exercise its powers on a completed contract basis by division and by major product line within a division of a contractor or subcontractor; however, with respect to contracts requiring more than three years to complete, the Board would be empowered to conduct renegotiation on a percentage-of-completion basis by division and by major product line within a division of a contractor or subcontractor.

Industry representatives

A majority of industry responses to the Joint Committee staff urged the retention of renegotiation on the basis of aggregate fiscal year receipts or accruals. Generally, it was suggested that a change to another basis would impose costly additional recordkeeping burdens for business. Furthermore, industry respondents maintained that classification of some product lines would be impractical; they also asserted that there is considerable definitional problems as to what is a particular product line.

One commentator, however, favored renegotiation on a product line basis to eliminate the "inequity" to small businesses that do not have

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[6] *Ibid.*, p. 19.

[7] Hearings on H.R. 9534 ("Renegotiation Amendments Act of 1975"), House Subcommittee on General Oversight and Renegotiation, Sept. 19, 1975.

[8] Hearings, House Subcommittee on General Oversight and Renegotiation, July 29, 1975, p. 300.

a varied product line consolidated filing. Another commentator believed that above some relatively high minimum (say, $10 million) product line renegotiation might be appropriate.

Other proposals

One proposal which has been made by a Government procurement official would eliminate any use of the percentage-of-completion method of accounting, thus requiring the contractors to make their renegotiation filings on the same accounting basis as the one on which the contract was awarded. Also, it was suggested that if the contractors would be filing on the completed contract method of accounting then the services of the Defense Contract Audit Agency (DCAA) could be used to assure compliance.

Staff Analysis

It appears that the Board does have statutory authority to renegotiate on the basis of separate contracts or a group of contracts *but only* at the request of the contractor. The regulations state, however, that use of any procedure other than on an aggregate basis may be employed "only if authorized by the Board." [9] Further, the Board may, if agreement is reached by all affiliated corporations, renegotiate such a group on a consolidated basis. The original renegotiation statute in 1942 did provide for a contract-by-contract renegotiation; however, this was changed in 1943 to the present method of aggregating renegotiable sales to allow contractors to offset loss contracts (or low profit contracts) against high or higher profit contracts during a fiscal year.[10] Renegotiation was changed from a contract-by-contract basis to an aggregate fiscal year basis also because it was considered to lessen the administrative problems of segregating costs, profits and capital attributable to each contract.

The Government Operations Committee emphasized the advantage that large, diversified companies (including the so-called conglomerates) have in averaging high and low profits on Government contracts in completely different lines of business. They pointed out that the structure of American corporations has changed substantially since the enactment of the Renegotiation Act of 1951, with one result that the conglomerate-type businesses may be able to avoid excessive profit determinations on some defense or space contracts by offsetting high-profit items against lower profits or losses in other areas of business with the Government. The Committee contended that this ability of the larger corporations of offsetting high and low profit (or loss) contracts constituted a competitive advantage against small companies who may not be able to "buy in" on a contract by underbidding on some contracts and making up the low profits or losses on other contracts. The Committee noted also that most excessive profit determinations by the Board have been against smaller companies.

On the other hand, it would appear that a short-term benefit inures to the Government in an underbidding situation since it may receive goods and services at a lower price initially. However, the quality of the product may not be as expected or needed; or, the contractor may

[9] Reg. 1457.1(b).

[10] Amendments to the 1951 Act provided for a two-year carryforward of a renegotiation loss (for fiscal years ending on or after December 31, 1956, and before January 1, 1959) and a five-year loss carryforward for later fiscal years.

raise the price later. There is also a question of fairness if the Government were to recoup high profits on one product as well as retain the benefits attributable to a product which is sold at a price resulting in losses or deficient profits. There is also a long-standing principle under Board regulations that contractors who "sell to the Government at lower prices will receive a more favorable determination than those who do not." [RB Reg. § 1460.8(a)]. Thus, it may be arguable that it is unnecessary to make an extensive change in the basic renegotiation rules for all contractors, which would result in the imposition of significant compliance burdens and an element of unfairness, because there is potential abuse in a relatively few cases—such as where underbidding would drive out competitors and thereby permit the contractor to capitalize in the future on being the sole source supplier. Moreover, it may be argued that the "small business set-aside programs" under the procurement process partially offset the so-called inequity to a single product contractor who cannot average high and low profit products for renegotiation purposes. Further, it may be argued that the long-term harm to the Government which might result from underbidding on a particular product is one which should be considered as a procurement or antitrust matter rather than as a renegotiation problem.

It seems clear that, for analytical purposes, the Board has the authority to review a contractor's filing on the basis of product lines, divisions, profit centers, etc. This proposition is embodied in the Board's Resolution of April 10, 1975, the Houston Report of March 18, 1974, and the General Counsel's opinion of February 22, 1974. It is also clear that the courts have applied the statutory factors in such a manner whenever it was appropriate to do so; for example, the Court of Claims examined the operations of particular plants in analyzing the contractor's operations in *Mason & Hanger-Silas Mason Co. v. United States* (Ct. Cl., June 25, 1975). It is also clear that the Board reviews contractor filings on the basis of particular types of contracts for certain analytical purposes; e.g., separate consideration is given to cost-type incentive contracts,[12] incentive and price redeterminable contracts in applying the efficiency factor,[13] and the risk assumed under certain types of contracts.[14]

It also seems clear that the Board is required to aggregate a contractor's renegotiable business in making a final determination even if it has reviewed a filing by product line, profit center, or division for analytical purposes. The regulations contemplate the offset of the results of one contract against the results of another.[15] This aggregation prevents the inequity which would result from renegotiating excessive profits from one contract or product but not making any allowance for losses or deficient profits on other contracts. Moreover, the loss carryover provisions accomplish a similar objective since a renegotiable loss carryover attributable to a certain product or type of contract is not limited to use against subsequent excessive profits on the same product or type of contract.[16] With respect to the potential abuse which could arise from the acquisition of a contractor who has a renegotiable

[12] RB Reg. § 1460.2(b).
[13] RB Reg. § 1460.9(b)(5).
[14] RB Reg. § 1460.12.
[15] RB Reg. § 1457.1(b).
[16] Sec. 103(m) of the Act and RB Reg. § 1457.9.

loss carryforward, the regulations provide for allowance if it is necessary to avoid inequity.[17]

In light of the Board's authority under present law to prepare an analysis on the basis of product line or contract-by-contract, it may be urged that an all-inclusive requirement for product line or contract-by-contract renegotiation would be an extremely burdensome requirement to eliminate abuses which may exist in a small fraction of cases.

Renegotiation by commodity groupings or product line groupings are said to involve some definitional problems, such as which groupings are to be used. For example, commodity grouping along the lines used in the Federal Supply Catalog apparently is not extensive enough to cover all the goods and services procured under renegotiable contracts or subcontracts as presently defined. Further, commercial or industrial financial data for profit comparisons are not collected presently on the basis of such commodity groups. In addition, there are different groupings of "product lines"—the 1972 Census of Manufacturers Code (4 digit or 5 digit), the 4-digit "Line of Business" Code of the Federal Trade Commission, and the 4-digit Standard Industrial Classification (sic) Code system. It has been suggested that there exists a significant amount of contamination in the reporting under these systems and, therefore, comparability would be suspect. Although this problem may exist under present law when the Board analyzes a contractor's business, required product line reporting for all contractors might severely aggravate this problem.

It is maintained that if renegotiation were to be conducted on a "product line" basis, contractor filings and data analysis would also have to be on the same basis. The number of filings would be increased as each company would have to file according to the number of "product lines" as defined. The question of an appropriate minimum "floor" by type of product would have to be determined. This would appear to involve a major substantive change in the renegotiation process. It would appear to require a significant increase in staff for the Board to properly process the filings on a product line basis.[18]

Staff Recommendations

The staff recommends that—

(1) The Act be amended to codify the Board's position that it has the authority to analyze renegotiable business by product line, profit center, segment or division, but that, generally, the final determination of excessive profits be made on an overall fiscal year basis by aggregating such product lines, profit centers, segments or divisions.

(2) As an exception to the general rule for aggregation for a fiscal year, the Board be given discretionary authority to make a final excessive profit determination on a product line, profit center, segmental or divisional basis where there are clear reasons for making such a determination—for example, where renegotiation on an aggregate fiscal year basis would result in allowing an offset against excessive profits for losses or below normal profits arising from an acquisition of another business, or adoption of a pricing policy, with the objective

[17] RB Reg. § 1457.9(e).

[18] It is noted, however, that the Board's proposed, revised RB–1 Form for contractor filings (not approved yet by OMB) would require the contractor to report data according to major product lines or segments, but not by SIC reporting.

of eliminating competition and thereby becoming the sole source supplier of a product or service.

G. "FLOOR" LEVELS

Principal Issues

The principal issues are whether to raise the respective "floor" levels, leave them at the present levels, or to lower the floors.

Present law

Section 105(f)(1) of the 1951 Act provides that renegotiation does not apply if the aggregate of the amounts received or accrued during a fiscal year by a contractor or subcontractor from covered Government Departments is not more than $1,000,000, in the case of fiscal years ending after June 30, 1956 ($500,000 for fiscal years ending on or after June 30, 1953, and $250,000 for fiscal years ending before June 30, 1953). The provision further provides that no determination of excessive profits to be eliminated for such year shall be greater than the amount by which the aggregate renegotiable receipts or accruals exceeds the floor. For example, if total renegotiable receipts or accruals was $1,028,000, and excessive profits were $100,000, only $28,000 would thus be eliminated. (In such a case, the Board's minimum refund rule, discussed below under topic D, would not apply since the original determination was $100,000, although the actual amount to be refunded was only $28,000.)

The minimum amount ("floor") for brokers' and agents' fees and commissions has been $25,000 since the inception of the 1951 Act (sec. 105(f)(2)). As is the case with the nonagent "floor," no determination of excessive profits to be eliminated for a year shall be in an amount greater than the amount by which such aggregate exceeds $25,000.

Proposals

Previous congressionally-sponsored studies

The recommendations of the three groups were: (1) House Government Operations—eliminate the floor (or lower it to $100,000);[1] (2) Commission on Government Procurement—raise the floor at $2,000,000 ($50,000 for brokers and agents' fees and commissions);[2] and (3) General Accounting Office—keep the floor at the present $1,000,000 level (and $25,000 for brokers and agents' fees and commissions).[3]

Current congressional proposals

Neither the Burton bill nor the Minish bill propose any changes in the current "floor" levels.

Renegotiation Board

The Board's 1975 legislative proposal includes raising the floor for brokers and agents to $50,000.

Industry representatives

Industry would generally prefer raising the floor levels to at least $2,000,000 and $50,000, respectively, while some suggest raising the levels to $3,000,000 or $5,000,000 and to $100,000 for brokers.

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[1] Government Operations Report, p. 15.
[2] Commission Report, p. 189.
[3] GAO Report (1973), p. 1.

Staff Analysis of Proposals

The House Government Operations Committee Report indicated that the removal of the minimum floor would appear to be feasible and economical in light of the administrative improvements that could be made through modern electronic data processing techniques. The Report stated "there is no logical basis for excluding contractors with renegotiable sales of less than $1 million, on either legal or moral grounds." [4] However, the Report suggested, as an alternative to complete elimination of the floor, a level of, say $100,000.[5]

The Commission on Government Procurement, on the other hand, recommended raising the minimum "floor" to $2,000,000.[6] They contended that as a result the Board could then focus its attention on the most significant areas of potential recoupment. Moreover, they indicated that this would also tend to relieve some of the reporting burden for small businesses. The Commission concluded that lowering the floor to $100,000 would call for a costly increase in the Board's staff.

It has been suggested that the floor levels should be raised to at least reflect inflation, in addition to the aim of reducing the number of small businesses having to file with the Renegotiation Board. The nonagent floor of $1,000,000 was last raised in 1956 (when it was raised from $500,000), while the agent floor has been $25,000 since 1951. It is noted that the GNP price deflator rose by about 100 percent from 1951 to 1974, and that it increased by about 95 percent from 1956 to mid-1975 (and further, that the percentage increase from 1956 to late 1975 should be at least 100 percent). Thus, it is maintained that the floors have been, in effect, reduced (in real terms) by about one-half since 1956 due to inflation, which has extended the coverage of the Act by reducing the "floor" in real value terms. It is, therefore, argued that both floors should be doubled merely to reflect inflation—that is, to $2,000,000 for nonagents and $50,000 for agents. In addition, some have proposed raising the "floor" levels further as a means of allowing the Board to concentrate on the larger cases. On the other hand, others contend that the inflation factor should not be used as a general excuse for raising the floors because a number of the excessive profits determinations have been made against firms with renegotiable sales of $1,000,000–$2,000,000 (as discussed below).

Data tabulated by the Renegotiation Board (Office of Planning and Analysis) indicate that if the floor for nonagents had been $2,000,000 during the five fiscal years 1970–1974, about 25 percent of the almost 20,000 filings reviewed by the Board would not have been covered. Raising the nonagent floor to $3,000,000 would have eliminated about 38 percent of the filings for the period, while increasing the nonagent floor to $5,000,000 would have removed about 51 percent of the filings from renegotiation during 1970–1974.

Regarding the impact of raising the nonagent floor level on the number of Board determinations during 1970–1974: if the floor had been $2,000,000, about 26 percent of the 689 excessive profit determinations would not have been made; and the percentage of determinations not made would have been about 43 percent and 58 percent with floor levels

[4] Government Operations Report, p. 15.
[5] Ibid.
[6] Commission Report, p. 189.

of $3,000,000 and $5,000,000, respectively. The amounts of excessive profit determinations eliminated (in gross amounts) would have been about $21 million with a $2,000,000 floor, $45 million with a $3,000,000 floor, and $73 million with a $5,000,000 floor. (These amounts represent about 8 percent, 18 percent, and 28 percent, respectively, of the $257 million in gross excessive profit determinations reported by the Board for the five fiscal years—i.e., before credits for State-local or Federal income taxes).

Estimates of filings (number and amounts) below the $1,000,000 floor are very difficult and uncertain due to changing procurement and business conditions, as well as because of the lack of data available on contractors and subcontractors below the floor.

Of the 1,748 agent filings reported in the Board's annual report as screened during the five fiscal years, 1970–1974, only 13 (or less than one percent) were found to have excessive profits. None of these had renegotiable receipts of less than $50,000 (and only three were from agents with receipts of $50,000–$100,000). The gross amount of excessive profit determinations (before income tax credits) for the 13 agent filings during this period was $940,000, of which $110,000 was attributable to the three agent cases with total renegotiable sales of $50,000–$100,000. If the agent floor had been $50,000 during this period, about two-fifths of the 1,748 total filings would not have been covered. If the floor had been $100,000, almost three-fourths of the total agent filings would not have been reviewed by the Board; however, as noted, only three of these cases between $50,000–$100,000 were determined to have excessive profits.

Staff Recommendations and Reasons

The staff recommends that the $1,000,000 general floor not be changed at the present time; however, the staff does recommend that the $25,000 floor for brokers and agents be raised to $50,000.

As pointed out above, there have been no excessive profit determinations made against agents with renegotiable receipts of less than $50,000 during the past five fiscal years (1970–1974), as reported by the Board. The staff believes that the $1,000,000 floor should not be reduced because it would expand the workload of the Board as well as probably result in relatively small amounts of excessive profit determinations (especially the net amounts after credits were subtracted for State-local and Federal income taxes).

H. MINIMUM REFUND LEVEL

The principal issues are whether there should be a minimum refund level at all, in view of the lack of a specific statutory authority, or whether the level should be increased.

Present Law

The Renegotiation Act of 1951 has no specific provision allowing the Board to exempt any amount of profits determined to be excessive. However, section 109 of the Act gives the Board authority to issue regulations as it deems necessary to carry out the statutory provisions. The Board's regulations[1] provide that if the level of "excessive profits" is less than $80,000 ($20,000 for brokers and agents),

[1] RB Reg. § 1460.5.

the Board will not make a determination of excessive profits. This level was raised administratively in 1972 from the previous minimum refund level of $40,000 ($10,000 for brokers and agents) which had been in the regulations since 1954.[2] The 1972 change (to $80,000 and $20,000) was effective for contractor fiscal years endings after December 31, 1970.

Proposals

Previous congressionally-sponsored studies

The General Accounting Office recommended that the Congress consider whether the minimum refund concept is appropriate, and, if so, whether the objectives in setting the minimum have been clearly stated and whether those objectives are being attained.[3]

Current congressional proposals

The Minish bill (H.R. 9534) would prohibit the Board from exempting any contractor or subcontractor from a determination on grounds of the amount of excessive profits found by the Board.

Renegotiation Board

The Renegotiation Board recommends that its authority to set a minimum refund level be retained.

Industry representatives

Recommendations of industry and its representatives have ranged from leaving the minimum refund at its present level to raising it to $1 million. One recommendation made by a consulting firm suggested that an increase to $150,000 would have freed the Board from pursuing 43.9 percent of the determinations of excessive profits it made in fiscal years 1972–1974, which, it is argued, would have enabled the Board to concentrate on larger, more important cases.

Other proposals

An economist responding to the Joint Committee staff suggested that the present minimum refund level is probably too low.

Staff Analysis of Proposals

Various reasons have been presented, primarily from industry, for increasing the minimum refund level. The Board has suggested that the minimum refund provision is appropriate because the amount of any determination of excessive profits is an imprecise figure, due primarily to the subjectivity involved in applying the statutory factors to determine excessive profits. Others question the sufficiency of this reason on the grounds that ignoring determinations of excessive profits below the level does not recognize the fact that determinations below the minimum refund level are, if anything, more precise than determinations of larger excessive profits. These persons assert that consistency in carrying the imprecision argument to its logical end would require an exemption of the first $80,000 of excessive profits in all

[2] Prior to the 1954 increase to $40,000, the minimum refund level (set by regulation) was: $20,000 in 1953, $10,000 from 1951 to 1953, $5,000 during the existence of the 1948 Act, and $10,000 during the life of the 1943 Act. The special level for agents and brokers was initiated in 1954.

[3] The GAO noted that 29 excessive profit determinations for an aggregate of $1.6 million would not have been made in fiscal 1972 had the subsequently increased level of $80,000 been in effect that year. (GAO Report (1973), p. 48.)

determinations, no matter how large. Persons opposed to the minimum refund provision also maintain that it wastes the considerable man-hours spent in deciding that excessive profits of less than the level have been earned.

Some assert that the level should be increased because of inflation. Others object that inflation is not in itself a justification for a minimum refund level, but only a possible factor in measuring the size of any level. Still others have maintained that increasing the level would benefit small businesses, which appear anyway to be the subjects of a disproportionate amount of the Board's determinations. Others object that this purpose is achieved through the "floor" level, which is the amount of renegotiable receipts or accruals (currently $1,000,000 annually) a contractor or subcontractor must have before being subject to renegotiation.[4]

Some maintain that the level should be increased to reduce the cost to the Government of proceeding further in cases involving relatively small determinations of excessive profits. However, it appears that most of the cost to the Renegotiation Board has already been incurred when it appears that a determination of excessive profits of less than $80,000 is involved. The Government incurs further cost only if the contractor appeals to the Court of Claims, in which case the Government's cost is borne primarily by the Department of Justice.

One Department of Justice official suggested to the Joint Committee staff that the Government's cost in prosecuting an average renegotiation case is about $30,000.[5] Industry representatives and their attorneys report that the average cost of litigation to a contractor is substantially higher than the Government's cost.

Others maintain that excessive profits should be pursued by the Government, as a matter of principle, regardless of the comparative costs involved. Those who maintain that the minimum refund level should be eliminated generally point to the lack of a specific statutory authority; they also object to the undesirable "notch" effect achieved when $80,000 of excessive profits are determined while, for example, excessive profits of $79,000 escapes entirely. Others, however, generally cite the arguments previously listed for increasing the level as arguments for preserving the minimum refund provision.

Staff Recommendations and Reasons

The staff recommends that the Renegotiation Board be directed not to set any specified minimum refund level (an amount below which excessive profits determinations will not be pursued). Under the Board's present regulations, determinations of excessive profits below $80,000 ($20,000 for brokers and agents) are not pursued by the Renegotiation Board although this practice is not specifically authorized by statute. The staff has concluded that there are no justifiable reasons for setting a particular minimum level of excessive profits that will not

[4] "Small businesses" do not receive benefit from the minimum refund provision in addition to the exemption they receive from the $1,000,000 floor. Excessive profits determinations are collected only to the extent the aggregate receipts or accruals exceed the $1,000,000 floor. However, even those total determinations must be for $80,000 or more, although the amount of refund actually sought may be less (as described above under "Floor levels").

[5] Since the Government must offset almost half of what it wins in a renegotiation proceeding back to the contractor in a tax credit for Federal income taxes already paid on such profits, the Government can only gain about $40,000 from an $80,000 (the minimum refund level) renegotiation case, if successful. This $40,000 gain, of course, is in excess of the Government's litigation average cost estimate of $30,000.

be pursued. If the Board determines such levels are "excessive," then the contractor should not be allowed to avoid payment.

To one reason that appears to have some meaning, the costs-of-litigation argument, is less persuasive when it is considered that the Government personnel involved (including court personnel) would in all probability continue to draw their salaries whether or not they had renegotiation cases to litigate. Even accepting the costs-of-litigation argument, the present level of $80,000 would appear to be high.

It should be pointed out that the Board may overlook truly minor amounts of excessive profits, even if the minimum refund level is discontinued, by the simple expedient of not determining excessive profits to exist in such cases. It also may be presumed that the Department of Justice will attempt to minimize litigation costs by making special efforts to settle renegotiation cases out of court that involve relatively minor amounts, if such cases were to be appealed by contractors.

I. BOARD STRUCTURE

It has been suggested that the Renegotiation Board should either be a Congressional agency similar to the General Accounting Office, or that it be granted a greater degree of independence in its operations and policy recommendations than exists under present law.

Present Law

Under Section 107(a) of the Act, the Renegotiation Board is classified as an independent establishment in the executive branch of the U.S. Government. As an independent establishment of the executive branch, the Board is subject to the oversight and supervision of the Office of Management and Budget on many policy and administrative matters, such as the agency budget, legislative proposals, staffing needs, and the approval of forms designed by the staff of the Board.

So far as its relations with Congress are concerned, Section 114 of the Act requires the Board to submit to Congress annual reports on its activities, including information on employees, administrative expenses, statistics on filings and Board determinations, changes made by the Board in its regulations and operating procedures, and the caseloads and dispositions by the courts of renegotiation cases. In addition, Board members and staff testify at Congressional hearings on the Board's budget and legislative proposals.

Proposals

Previous congressionally-sponsored studies

There were no recommendations on this issue by the House Committee on Government Operations, the Commission on Government Procurement, or the GAO.

Renegotiation Board

The Board also made no recommendations on the issue.

Industry representatives

Responses to the Joint Committee staff on this issue were almost unanimous in recommending that the Board remain an executive agency. One respondent also felt that consideration be given to placing the Board in the Department of Defense, with the Secretary of Defense

responsible for appointment of Board members. Several other respondents, who favored retaining the Board as an executive agency, expressed a belief that the Board should be more independent but made no specific recommendations on how this was to be achieved.

Other proposals

One respondent to the Joint Committee staff proposed that the Board be made a congressional agency.

Staff Analysis of Proposals

There are two basic reasons for suggestions that the Board be made more independent. First, the requirement that a wide variety of Board proposals and initiatives be submitted for OMB approval often results in lengthy delays in response or approval from OMB. These delays and the degree of control exercised by OMB often prevent the Board from reacting in a timely fashion to new problems. Moreover, it appears that the Board's legislative proposals and budget recommendations are often changed substantially because of opposing viewpoints held by other Administration officials. There is also the possibility that the Board may be subject to political pressures from time to time.

It is argued that the present procedure for reporting Board activities to Congress is insufficient in that it fails to notify the Congress of the basic policy and administrative problems the Board is encountering. It is questionable that a reporting requirement of such information under present procedures would be entirely satisfactory in any event, since the Board's legislative proposals are filtered through administration officials outside of the Board (such as OMB), which often results in alterations to the original proposals.

The staff also considered the argument that the Renegotiation Board should be reclassified as an agency of Congress, similar to the status of the General Accounting Office. However, there are significant differences between the functions of the Renegotiation Board and those of the General Accounting Office, which differences reasonably preclude placing the Renegotiation Board under the Congress. For example, the functions of the General Accounting Office are, generally stated, the conduct of audits and other investigations concerning the collection and expenditure of Government funds and to make recommendations regarding improvements on such matters.[1] In contrast, the Renegotiation Board performs quasi-judicial functions (similar to those of the administrative judges found in many independent executive agencies) involving the renegotiation of profits on contracts entered into by certain other agencies of the executive branch. The Board's functions could consequently be broadly categorized as directly involving either the collection or the expenditure of Government funds, with the latter categorization the most accurate. Since these are basically executive branch functions, it is argued that the Renegotiation Board should remain in the executive branch.

Probably one of the most effective means of promoting greater independence and initiative on the part of the Board would be to provide the Board members with fixed terms of office. (See later discussion on "Board Organization and Membership.")

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[1] 31 U.S. Code §§ 53, 67.

Staff Recommendations and Reasons

The staff believes that the Board should remain as an independent agency within the Executive Branch; nevertheless, during the 6-year extension period, it is recommended that the Board be required to (1) submit any budget or other legislative proposals to Congress at the time of submission to the Office of Management and Budget, and (2) make detailed, periodic reports to Congress on operations and changes in organization and procedure in addition to the largely statistical annual reports the Board now makes to Congress.

This will give the congressional committees having jurisdiction over the activities and budget of the Board a better opportunity to perform their oversight and budget responsibilities by knowing what the Board's proposals are for changes in policy and staffing needs.

J. BOARD ORGANIZATION AND MEMBERSHIP

In summary, the principal issue concerning the Board's organization and membership are:

(1) Whether there should be limited terms;

(2) Whether the number of Board members from one political party should be limited;

(3) Whether the Chairman should be statutorily empowered to deal with administrative matters;

(4) Whether there should be specified conflict-of-interest requirements; and

(5) Whether relevant experience should be require for appointees to the Board.

Present Law

The Renegotiation Board is comprised of five members, who are appointed by the President with the advice and consent of the Senate (Sec. 107(a) of the Act). The Secretaries of the Army, Navy and Air Force and the Administrator of General Services are each directed to recommend to the President one civilian person for appointment to the Board. One appointee is designated by the President as Chairman. The members of the Board presently have no fixed terms and serve at the pleasure of the President. All members of the Board are presently compensated at the rate of $36,000 per year (Executive Level V), and they are prohibited from engaging in any outside business or employment.

Under present law, the Board operates as a plural executive in administering the Board's operations with the full Board responsible not only for setting policy but also for deciding day-to-day administrative questions. The only power which is now vested specifically in the Chairman by statute is that to appoint "divisions" of one or more Board members to consider certain cases. (However, the Joint Committee staff understands that the Board members have in the past delegated the administrative powers to the Chairman.)

Proposals

Previous congressionally sponsored studies

The only proposal in this category made by one of the three previous studies was that of the House Committee on Government Opera-

tions, which recommended that the President should appoint persons with high levels of expertise and experience in Government procurement, accounting and other specialties directly related to the renegotiation process.

Current Congressional Proposals

The Burton bill (H.R. 5940) proposes staggered five-year terms, with appointments to fill unexpired terms to be for the period of the unexpired term.

The Minish bill (H.R. 9534) proposes the following changes: (1) set 5-year staggered terms for Board members; (2) appointments to fill vacanies are to be for the unexpired term; (3) no more than three members are to be from the same political party; and (4) give statutory administrative authority to the Chairman of the Board, and designate him as the "chief executive officer."

Renegotiation Board

In his July 29, 1975, presentation to the House Subcommittee on General Oversight and Renegotiation, Chairman Holmquist recommended: (1) that Board members serve for seven-year terms on a staggered basis; (2) that no more than three of the five board members be of the same political party; and (3) that the administrative duties and functions be formally transferred to the Chairman. It was also recommended that the compensation of the Chairman be increased from the $36,000 presently paid to all Board members to $38,000 (an increase in compensation status from Level V to Level IV of the Executive Schedule).

Earlier this year, the Board reached conclusions on these issues which differed in two minor respects from those stated above. In its March 27, 1975, letter to the Office of Management and Budget requesting OMB clearance for a series of legislative recommendations, the Board asked that the compensation of the Chairman be raised to Executive Level III ($40,000) and that the other Board members be raised to Level IV ($38,000). It also recommended repeal of the statutory requirement that the Secretaries of the Army, Navy and Air Force and the Administrator of General Services each make recommendation to the President of a person to be a member of the Board. The remainder of the Board's recommendations in this category were the same as those set forth by Chairman Holmquist on July 29.

Industry Representatives

Only a minority of the industry representatives who responded to the Joint Committee staff on these issues were of the opinion that the Board organization and membership should remain unchanged. The majority who recommended some change believed that fixed terms should be provided; and it was observed that some relevant business, professional or government experience should be required for Board nominees. It was also recommended that the Board be made bipartisan (with a suggested maximum membership of three from any one political party), and that the Chairman should be assigned the administrative powers of the Board. One respondent suggested that there be given "due regard" to conflict of interest. There were no recommendations from this group on compensation increases.

Staff Analysis

Under present law, the Renegotiation Board functions with fewer of the statutory directives and requirements than are imposed on other independent establishments of the executive branch in order to encourage the conduct of their duties in an impartial and competent manner. It would seem that provisions for similar standards and guidelines for the Renegotiation Board have been largely ignored in the past.

Many of the other independent establishments have organizational standards similar to those which the Board is recommending for adoption. For example, the Securities and Exchange Commission is composed of five commissioners appointed for five-year terms on a staggered basis with no more than three Commission members from the same political party.[1]

Similarly, the eleven members of the Interstate Commerce Commission are appointed for staggered seven-year terms, with no more than six from the same political party.[2] The organiational statutes of such other agencies as the Civil Aeronautics Board and the Federal Trade Commission also contain provisions for limited, stagggered terms and bipartisan membership.

Many of the other independent establishments have also been the subjects of reorganization plans at various times under which the administrative functions for the agency have been transferred from the board or commission as a whole to its chairman. These reorganization plans have typically reserved to the entire appointive board or commission powers to set general policy, appoint heads of major administrative divisions, and to make decisions concerning budget estimates and the distribution of appropriated funds among major programs. The executive and administrative powers typically transferred to the chairman in the reorganization plans include those concerning the appointment and supervision of agency staff, distribution of workload, and the use and expenditure of funds.

On the question of conflict-of-interest, the members and staff of the Renegotiation Board, as officers and employees of the U.S. Government, are subject to the variety of existing statutory rules generally governing standards of official conduct found in Title 18 of the U.S. Code, such as the rule which prohibits a Government employee or officer from participating in an official action concerning a matter in which he has a direct, indirect or prospective economic interest.[3] Another provision of Title 18 also prohibits, for a period of one year, the involvement in a private capacity of a former public officer or employee in matters which he acted upon as a public official.[4] In addition, the Renegotiation Act itself prevents outside employment or business activities by the Board members. This array of preventative rules (if properly enforced) would appear to provide an adequate framework to protect the public interest.

Among the arguments put forth for providing Board members with fixed terms and bipartisan membership are that such measures would make the Board's deliberations more independent and provide a degree

[1] 15 U.S.C. § 78d.
[2] 49 U.S. Code § 11.
[3] 18 U.S. Code § 208.
[4] 18 U.S. Code § 207.

of insulation against outside influence. It is also argued, in conjunction with the question of whether the Renegotiation Act should be granted a longer or unlimited extension, that a lengthened existence will tend to promote long-term planning and the solution of basic policy issues. It is also felt that provisions for fixed terms of sufficient length will provide some impetus to the Board to resolve outstanding issues and refine its operations.

Staff Recommendations and Reasons

The staff recommends:

(1) 5-year staggered terms for Board members;

(2) providing that when a member's term has expired, the member is to continue to serve until a new member (or the reappointed member) is ready to assume office, but in no event longer than 6 months;

(3) providing that the President is to designate a member of the Board to serve as Chairman;

(4) limiting the number of Board members of one political party affiliation to three;

(5) providing statutory administrative powers for the Chairman; and

(6) raising the salary of the Chairman to one level above that of the other Board members.

If these recommendations are adopted, it will be necessary to provide a system for expiration of the terms of the existing members. It is suggested that the first expiration date be one year from January 1, 1976, and that the terms of the other members of the existing Board expire at one-year intervals thereafter. The selection of the sequence of expirations for the existing Board members could be left to the President or a sequence could be provided by statute.

In order to encourage the maintenance of a full Board at all times, it should be provided that a Board member whose term has expired may continue to serve until his successor has qualified for office, except that the service of such "lame duck" members may not continue beyond a definite period (unless they are reappointed), such as six months. Where a vacancy occurs before the expiration of a member's term, it is necessary to provide that his successor shall serve only for the remainder of his term. As has been already noted, the above recommendations are typical of the statutes under which numerous other independent establishments are organized.

The staff also concludes that the Chairman should be granted the day-to-day executive and administrative functions of the Renegotiation Board. Although the Chairman presently performs these duties under a long-standing Board resolution, statutory authorization would eliminate uncertainty on this question. Such a delegation of authority is recommended to improve Board efficiency by freeing the time of other members from administrative details. Such delegations of administrative authority have occurred, under reorganization plans at various times, for other independent agencies in the executive branch. These other reorganization plans have also granted the President authority to appoint one member of the agency as Chairman (such as when a new President begins office).

Finally, it is recommended that the Chairman's compensation be increased to one level above the other Board members in recognition of his additional administrative responsibilities.

The staff also concludes there is no apparent need for additional conflict-of-interest requirements. The existing sanctions for self-dealing and other conflicts of interest, if enforced, appear to provide sufficient protection for the public interest. Similarly, the system of checks and balances inherent in the existing procedure of Presidential appointment and Senate confirmation should afford ample opportunity to examine the qualifications of a prospective Board member. Although the staff does not see a necessity for statutorily requiring and defining "relevant experience" for Board members, the staff does agree with the concern of the House Government Operations Committee that it is important that Renegotiation Board appointments be made on the basis of expertise and experience rather than on the basis of "political" service.

K. BOARD STAFFING AND BUDGET

The issues include whether the Board has sufficient staff to properly perform its duties under the Act; particularly, it has been argued that the Board does not have adequate staffing in the screening and review process, in research and planning, in economic analysis, and in legal analysis.

Present Board Staff Level and Expenses

Overall Board staff

Presently, the Board has an OMB-authorized staff ceiling of 200 employees. As of June 30, 1975, the Board had a total of 194 employees, which includes Board members and professional, clerical, and secretarial staff (77 in the latter two categories).[1] This was an increase of 11 employees from June 30, 1974, but was down from the 223 employees at the end of fiscal 1972 and 239 at the end of fiscal 1971. The following is a comparison of the total number of Board employees for selected fiscal years (as of the end of each fiscal year):

NUMBER OF RENEGOTIATION BOARD PERSONNEL

End of fiscal year	Total	Headquarters	Regional offices
1953	742	178	564
1955	430	193	347
1957	359	155	204
1960	284	103	154
1963	223	131	92
1965	184	108	76
1967	178	102	76
1969	199	96	103
1970	232	112	120
1971	139	114	125
1972	223	109	114
1973	201	106	95
1974	183	104	79
1975	194	108	86

[1] Renegotiation Board, Office of Planning and Analysis.

Board expenses

The Board's expenses for salaries and other costs have been as follows for selected fiscal years:

RENEGOTIATION BOARD EXPENSES

[Thousands of dollars]

Fiscal year	Total	Salaries	All other
1953	5,093	4,444	650
1955	4,389	4,160	229
1957	3,514	3,320	194
1960	2,814	2,511	303
1963	2,325	2,025	301
1965	2,577	2,286	291
1967	2,533	2,238	294
1969	3,069	2,673	396
1970	3,967	3,481	486
1971	4,530	3,990	540
1972	4,754	4,148	606
1973	4,832	4,121	711
1974	4,684	3,941	743
1975	5,298	4,601	697

Board professional staff

Of the 194 Board employees as of the end of fiscal 1975, 77 were clerical or secretarial. Thus, there was a total of 117 "professional" staff, including the Statutory and Regional Board Members. The Board employed a total of 48 accountants, including 35 at the regional offices (4 supervisory) and 13 at the headquarters office (3 supervisory).[2] The ten nonsupervisory accountants at headquarters were involved in the screening process as well as in review of cases reassigned from the regional offices to the headquarters office and other special projects. There was also a total of 11 other nonsupervisory professionals (financial and business analysts) in the Office of Review (plus 6 supervisory staff) at headquarters, which involves the screening of filings, review of exemption requests, analysis of cases reassigned to the headquarters from the field, and other special projects). In addition, there were four financial analysts in the assignments division of the Secretary's Office (in addition to the Secretary and a financial analyst, who acts as the Board's "Small Business Advisor") that were involved in the initial processing of filings received, prior to further accounting and financial analysis by the Office of Accounting and Office of Review.

Other professional staff at the headquarters office include three in the Office of Planning and Analysis (one Economist, as Director, and two Program Analysts). This office was established as a result of the February 1974 reorganization, in which the former Economic Advisor was made Director of the new Office of Planning and Analysis (with authority to add the two new Program Analysts)[3] There were six attorneys in the office of General Counsel (including the General Counsel and Assistant General Counsel), plus two attorneys in the regional counsels' offices. Further, there were six professional staff in the Office of Administration (including the Director and

[2] In addition to the 35 accountants in the two regional offices, there were 15 financial analysts (or "renegotiators") in the regional offices. Thus, there was a ratio of about two accountants to one renegotiator in the field offices.

[3] See Board reorganization description, Appendix C–2.

the Personnel Director). Finally, each of the Statutory Board members has a Special Assistant (or Executive Assistant in the case of the Chairman). The Chairman's Executive Assistant also serves as the Board's Equal Employment Opportunity Director.

Proposals

Previous congressionally-sponsored studies

The report of the House Committee on Government Operations is the only one of the three studies which treated the personnel requirements of the Renegotiation Board as a separate area of review. Even then, the review never dealt with specific details, concentrating instead on a consideration of the principle that if the Board had more staff it could do a more thorough job of screening, analyzing, and renegotiating the volume of filings it receives each year. Rather than making specific recommendations in this area, such as the number of additional employees to be hired, and in which categories, the Committee instead called for a "substantial increase" in the Board's staff and requested that a detailed analysis of staff needs and organization be made at a later date by the GAO.[4] The 1973 GAO report to Congress on the Renegotiation Board, however, did not contain a detailed analysis of the Board's employment requirements to meet its current responsibilities, nor did it contain recommendations for staff reorganization. Further, in recommending several changes in the current renegotiation process, the GAO did not attempt to measure their implications either in terms of additional workload or manhours.

Current congressional proposals

Neither the Burton bill nor the Minish bill make any specific reference to staffing levels for the Board. However, several members of the Subcommittee on General Oversight and Renegotiation indicated during recent hearings on the Renegotiation Act that the Board should have more staff, both to reduce the increased backlog and to provide more thorough screening and analysis of the filings received by the Board.[5]

Renegotiation Board

In its fiscal 1976 budget presentation to the Congress, the Board recommended (as approved by OMB) that the total authorized employment level remain at 200, the same as for fiscal 1975 and fiscal 1974.[6] The Board's forecast was for an average employment level of 198 full-time employees in fiscal 1976, at a total estimated cost of $5.4 million (as compared to $5.3 million for fiscal 1975). In its fiscal 1976 budget presentation (p. 695, *supra*), the Board noted that they estimated an increase in the case backlog from approximately 1,176 at the end of fiscal 1975 to about 1,251 at the end of fiscal 1976. The Board did not make a request to the Congress during the appropriations hearings for increased staff above the 200 ceiling as previously authorized by OMB. Chairman Holmquist did indicate, however, in his

[4] Government Operations Report, pp. 10, 12–13.

[5] See Hearings before the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing, "Oversight of the Renegotiation Act," 94th Cong., 1st sess., pp. 113–158 (June 10, 1975).

[6] See Hearings, Subcommittee on the Departments of State, Justice, and Commerce, the Judiciary, and Related Agencies, of the House Committee on Appropriations, Part 6 ("Related Agencies"), p. 693 and following (May 13, 1975).

July 1975 testimony before the Subcommittee on General Oversight and Renegotiation, that he intended to ask OMB for a supplemental for fiscal 1976.[7] Previously, in February 1975 the Board submitted an amended budget request to OMB for almost a 50-percent increase in personnel for fiscal 1976, but which OMB rejected. (See discussion below under "Staff Analysis of Proposals.")

Industry Representatives

Of the industry comments received by the Joint Committee staff, most indicated that the present Board staff level was adequate.

Other Proposals

A former Chairman of the Renegotiation Board indicated to the Joint Committee Staff that the Board's present staff level is adequate. Comments from other nonindustry respondents, however, maintained that the Board needs additional staff.

Staff Analysis of Proposals

Board staff general workload and case backlog

The Board has averaged slightly over 3,300 filings being screened per year at the headquarters office for the fiscal years 1973–1975. The percentage of the cases being assigned to the regional offices for analysis, however, has about doubled from 10.4 percent in fiscal 1973 to 21.4 percent and 20.7 percent in fiscal 1974 and 1975, respectively. This is a return to the percentage level of assignments made in fiscal 1969 (20.1 percent). The number of cases assigned to the regional offices rose from 232 in fiscal 1973 to 783 in fiscal 1974 and 673 in fiscal 1975.

The regional backlog has almost doubled from 665 at the end of fiscal 1973 to 1,041 at the end of fiscal 1974, and to 1,308 at the end of fiscal 1975. This has occurred while the employment at the regional office has declined from 95 at the end of fiscal 1973 to 86 at the end of fiscal 1975. The backlog of cases at the headquarters office has increased from 344 cases at the end of fiscal 1974 to 411 at the end of fiscal 1975. The backlog of filings in the screening process at headquarters increased from 1,863 at the end of fiscal 1974 to 3,026 at the end of fiscal 1975, for an increase in backlog of 1,163 filings. Yet, the headquarters employment has remained about the same during fiscal 1973–1975.

Office of Administration

The Office of Administration is responsible for providing administrative and management services to the Board (See organization chart, Appendix C–1.) These services include management analysis, personnel matters, electronic data processing, budget preparation, library and freedom of information services, office services and supply, and other clerical and administrative services. Pending projects that the Director was participating in as of the end of fiscal 1975 included: (1) revision of instructions for filing renegotiation reports, (2) overage assignments in the Eastern Regional Board, (3) statement of Board organization and (4) computer coding study.[8]

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[7] Hearings, Subcommittee on General Oversight and Renegotiation, pp. 330–31 (July 29, 1975).

[8] Data on fiscal 1975 operations and pending projects in this discussion are from: "Workload and Status Report for June 1975," Memorandum from the Office of Planning and Analysis to the Board, July 10, 1975.

Office of General Counsel

The Office of General Counsel is responsible for legal advice in all phases of the Board's operations. This office prepares Board regulations and amendments and interpretations of such regulations, bulletins, and rulings. It also drafts all legal forms, agreements, and orders of the Board; participates in each case pending before the Board; provides legal assistance in the granting or denial of applications for exemptions; provides support and guidelines to the Civil Division of the Department of Justice in the trials of renegotiation appeals before the Court of Claims; and such other legal advice as requested by the Board and research on legal questions requested by congressional committees. There were 65 new renegotiation cases filed in the Court of Claims during fiscal 1974, and 39 new cases filed in fiscal 1975. The Office of General Counsel reviews the case files for each case and prepares litigation reports or gives an initial briefing to the Justice attorney assigned to the case. There were 151 cases open before the Court of Claims at the end of fiscal 1974, and 157 cases at the end of fiscal 1975.

Pending Board projects (as of June 30, 1975) that the General Counsel was participating in included: (1) revision of instructions for filing renegotiation reports, (2) extended application of CASB standards, (3) cost allowances related to oil companies, (4) over-age assignments in the Eastern Regional Board, (5) implementation of policy on conglomerates, (6) Staff Guide on records management, (7) coverage of bank leasing, and (8) guidelines to implement Board's April 10 resolution on obtaining contractor data by product line, division, profit center, etc.

Office of Planning and Analysis

As stated in the Board's organization chart, the Office of Planning and Analysis is responsible for analyzing and evaluating the effectiveness of current programs and the planning of projected programs. This includes such areas as "policies, standards, and criteria used in the renegotiation process," as well as planning and conducting economic studies and surveys and compiling the data (month-by-month accumulation during the year) for and preparing the annual report of the Board to the Congress. In addition, the Office responds to Board, congressional and other inquiries for research and special analyses.

The Director of the Office of Planning and Analysis was (as of June 30, 1975) participating in several pending Board projects: these included (1) revision of instructions for filing renegotiation reports, (2) extended application of CASB Standards, (3) renegotiability of foreign military sales, (4) over-age assignments in the Eastern Regional Board, (5) Standards of Practice Manual, (6) implementation of policy on conglomerates, and (7) adjustment for foreign income taxes.

Office of the Secretary

Contractor filings are initially received by the Office of the Secretary, which makes an examination of the filings to determine the adequacy of the contents, before the filings are screened and analyzed by the Office of Accounting and the Office of Review for possible assignment for full-scale renegotiation in the regional offices. This office also identifies contractors who may be subject to renegotia-

tion; provides technical and procedural advise to contractors regarding filing requirements and Board actions; processes agreements and orders for collection of excessive profit determinations; keeps official records of Board actions; and signs and transmits Board determination correspondence (orders and clearances) to contractors. In addition, the Secretary's Office provides guidance to small businesses.

The Office of the Secretary processed 3,586 filings during fiscal 1974 and 3,254 filings during fiscal 1975. The backlog of filings in this part of the screening process rose from 672 at the end of fiscal 1974 to 1,126 at the end of fiscal 1975. As of the end of fiscal 1975, the Secretary was involved in a pending Board project regarding the procedure for reviewing "Statements of Non-Applicability" involving bank leasing operations.

Office of Accounting

The Office of Accounting provides technical accounting advice and assistance to the Board and develops accounting policy and principles related to the renegotiation process. The office also analyzes the accounting aspects of contractor filings in the screening process, and evaluates the adequacy and correctness of the contractor's segregation of renegotiable and nonrenegotiable sales and the related allocations of costs and expenses to determine whether additional accounting information is needed. In this review of contractor filings, the Office of Accounting processed 3,560 filings during fiscal 1974 and 3,082 filings during fiscal 1975, with an increase in backlog of filings from 719 at the end of fiscal 1974 to 891 at the end of fiscal 1975.

The Director of the Office of Accounting was participating (as of June 30, 1975) in the following pending Board projects: (1) revision of instructions for filing renegotiation reports, (2) extended application of CASB standards, (3) adjustment for foreign income taxes, (4) coverage of bank leasing, (5) cost allowances related to oil companies, (6) renegotiability of foreign military sales, (7) over-age assignments in the Eastern Regional Board, and (8) implementation of policy on conglomerates.

Office of Review

The Office of Review analyzes all above-the-floor filings after the Office of Accounting completes its evaluation of the accounting statement and allocation of costs. The Office of Review has authority to assign filings to the Regional Boards for detailed investigation; and it also makes recommendations to the Board to clear filings, except that this office can clear filings without Board approval in cases where renegotiable sales are less than $10,000,000 and/or where renegotiable profits are less than $200,000. In fiscal 1974, the Office of Review processed 3,586 above-the-floor filings; whereas it processed 2,544 filings in fiscal 1975, with an increase in backlog from 468 filings at the end of fiscal 1974 to 1,006 filings at the end of fiscal 1975.

The Office of Review also provides assistance to the Board in all cases reassigned from the regional offices, and prepares the Board Opinions and Statements of Facts and Reasons setting forth the renegotiation findings and rationale of the excessive profits determinations or the clearances. In addition, the office maintains liaison with the various procurement agencies subject to renegotiation and obtains procurement

and contract performance information as needed. Further, this office evaluates requests by contractors for the various exemptions provided by the Act. The Office of Review received a total of 452 applications during fiscal 1975 for the various exemptions, and completed processing of 371 of the applications. There was an increase in the backlog in the exemption application process from 155 at the end of fiscal 1974 to 236 at the end of fiscal 1975.

The Director (or Deputy Director) of the Office of Review was participating (as of June 30, 1975) in the following pending Board projects: (1) revision of instructions for filing renegotiation reports, (2) extended application of CASB standards, (3) issues of oil company filings, (4) adjustment for foreign income taxes, (5) cost allowances related to oil companies, (6) over-age assignments in the Eastern Regional Board, (7) use of statistics in the screening process, and (8) implementation of policy on conglomerates.

Regional Board Staff

As mentioned previously, there was a total of 86 employees in the two regional offices at the end of fiscal 1975; 55 in the Eastern regional office and 31 in the Western regional office. This represented an overall increase of 7 employees from the end of fiscal 1974, but it was still lower than the 95 employees at the end of fiscal 1973 and 114 at the end of fiscal 1972. The regional offices are assigned cases for a more detailed review to determine whether excessive profits exist, or to resolve accounting or data problems as spotted by the headquarters office. The regional offices were assigned 673 cases in fiscal 1975, and completed 405 cases. This compares to 783 assignments and 407 completions in fiscal 1974. The backlog of cases at the regional offices increased from 665 at the end of fiscal 1973 to 1,041 at the end of fiscal 1974, and further to 1,308 at the end of fiscal 1975.

The Board's request for additional staff

In February 1975, the Board sent a revised budget request to OMB for fiscal year 1976 (and the last 3 months of fiscal 1975). The Board requested an increase in total staff to an average employment of 292 for fiscal 1976, up from the estimated fiscal 1975 average of 197 employees.[9] This would have represented an average increase of 95 employees, or almost 50 percent. The estimated total budget cost after such a personnel increase was estimated to be $7.7 million, or $2.3 million higher than the OMB-approved fiscal 1976 budget request of $5.4 million.[10] The Board's revised budget request indicated that the increase over 1975 levels in personnel would be utilized as follows: 5 in the Office of Administration, 3 in the Office of Planning and Analysis, 9 in the Office of General Counsel, 14 in the Office of Accounting, 15 in the Office of Review, 4 in the Office of Secretary, and 46 additional employees in the regional offices.[11]

In April 1975, OMB rejected the Board's requested increase in fiscal 1976 staff and budget, indicating that the President's previous budget recommendations "provide an adeqaute level of funding for the currently defined activities of the Board during 1975 and 1976."[12]

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[9] Renegotiation Board letter and budget transmittal justification to OMB, Feb. 11, 1975.
[10] *Ibid.*
[11] *Ibid.*
[12] Letter from the Office of Management and Budget to the Renegotiation Board, Apr. 23, 1975.

OMB further stated: "We have not identified any new information or change in circumstances that would warrant asking the President to adjust his budget request for the Board." [13]

Staff Recommendation and Reasons

The staff believes that there is a need to increase the Board's staff in order to reduce the case backlog and to expedite the handling of cases assigned: more specifically, the staff recommends an increase in the Board's research and planning staff to work on guidelines for the statutory factors and other staff research matters; additional personnel in the screening process to provide a more thorough review of filings for possible assignment to regional offices for further analysis; strengthening the economic analysis capability (headquarters and regional offices) to assist in providing more concrete economic analysis in Board opinions and in developing industry economic analysis; and additional legal staff to allow the General Counsel's office to follow more closely cases referred to the Department of Justice as well as cases tried in the Court of Claims.

L. BOARD FIELD ORGANIZATION

The issues relating to the Board's field organization include whether the Board should grant the Regional Boards more authority to conclude cases without reassignment back to the Board; whether the Board should reserve to itself the final determination in all cases, with the regional offices being used primarily for data gathering and verification of contractor information; and whether the Board should have additional regional offices.

Present Field Organization

Under present law (Sec. 107(b) of the Act), the principal office (or "headquarters") of the Renegotiation Board is to be in Washington, D.C. The Board, or any division thereof, however, may meet and exercise its powers at any other place. Also, the Board may establish such offices "as it deems necessary to expedite the work of the Board." Presently, there are two regional boards: one in Washington, D.C. (the Eastern Regional Renegotiaion Board) and one in Los Angeles, California (the Western Regional Renegotiation Board). In previous years (prior to 1962), there have been additional regional offices in such locations as Chicago, Detroit, Boston and New York City.

The two Regional Boards each have three board members (and had five members prior to a 1971 reorganization), plus a regional counsel and an accounting and renegotiation staff. The regional accounting and renegotiation staffs analyze the cases assigned where the headquarters office feels there may be a possibility of excessive profits, or cases which involve accounting or other problems that cannot be resolved expeditiously in the headquarters. The regional staff obtains any additional accounting, financial or contract performance data they feel is needed in a particular case; they make plant visits to review complexity and efficiency of plant operations or to check the accounting or other financial records; and where necessary, hold meetings with the contractors. After a case has been reviewed and analyzed by the accounting and renegotiation staffs (in the past, this generally has involved one ac-

[13] *Ibid.*

countant and one renegotiator on a given case), a recommendation is made to the Regional Board to clear the case or to propose a determination of excessive profits.

At the time of assignment of a case to a regional board, the case is designated as either a "Class A" case or a "Class B" case. Generally, a Class A case involves renegotiable profits of more than $800,000 for a fiscal year, and Class B cases involve renegotiable profits of $800,000 or less.[1] In the cases involving brokers or agents, however, the dividing point is renegotiable receipts or accruals of $100,000.[2] Authority has been delegated to the Regional Boards to determine excessive profits and enter into final "agreements" (where the contractor agrees with the regional determination) in Class B cases, and also to clear such cases; otherwise, the case will be reassigned back to the Statutory Board for a final determination.[3] In other words, a case will be reassigned when a Regional Board makes a recommendation for a clearance or excessive profits determination in Class A cases or when it makes a "finding" of excessive profits in a Class B case where the contractor disagrees; in addition, the Statutory Board may reassign any case where it feels it should conduct the renegotiation proceeding.[4] In the Class B cases where the Regional Board recommends a clearance, the Regional Board will issue such clearance to the contractor, and at the same time, will furnish the contractor with a Final Opinion.[5] In the other cases, the Regional Board will furnish the contractor with a Regional Board Opinion,[6] a copy of which is then transmitted to the Statutory Board when the case is reassigned for Board consideration.

Cases assigned to the Eastern and Western Regional Renegotiation Boards have generally in the past been made on the basis of the geographic location of the contractor's headquarters, with the Mississippi River as the dividing line. However, as noted below under "Staff Analysis," the Board early in 1975 reassigned some cases from the Eastern Board to the Western Board because of an increased backlog of cases. Thus, some contractors with headquarters as far east as Ohio have been assigned to the Western Regional Board.

Proposals

Previous congressionally-sponsored studies

The three previously-mentioned reports by the House Government Operations Committee, the Commission on Government Procurement, and the GAO did not address the question of the Board's field organization.

Current congressional proposals

Neither the Burton bill nor the Minish bill mention the subject of the Board's field organization.

Renegotiation Board

The Board has not made any specific proposals to modify the organization or location of its field offices. However, the Board has been studying the problem of over-age cases in the Eastern Regional Board,

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[1] RB Reg. § 1471.2(b).
[2] RB Reg. § 1471.2(d).
[3] RB Reg. § 1472.4(a).
[4] *Ibid.*
[5] RB Reg. § 14.73.2(b) pursuant to Reg. § 1477.3.
[6] RB Reg. § 1473.2(a), pursuant to Reg. § 1477.3.

and has already reassigned a number of cases from the Eastern to the Western Regional Board.

Industry representatives

Comments received by the Joint Committee staff from industry representatives generally favored leaving the basic Board field organization as it is now. Some indicated, however, that this matter should be studied further, with possible expansion of the number of regional offices. Also, it was suggested that consideration be given to modifying the Board's procedures so that the headquarters would make the determinations, with the regional offices being used for field investigations and verification of contractor books and records, etc.

Staff Analysis

The backlog of cases in the regional offices increased from 1,040 at the end of fiscal 1974 to 1,308 at the end of fiscal 1975. During this time, the backlog for the Eastern Board increased from 733 (453 Class A cases and 280 Class B cases) to 870 (572 Class A cases and 298 Class B cases), while the backlog for the Western Board increased from 307 (228 Class A cases and 79 Class B cases) to 438 (359 Class A cases and 79 Class B cases). Part of the increase in backlog at both regional offices has been due to the assignment of numerous oil company cases for field review and the increased emphasis on the "DOD–100" contractors. Further, the Board recently decided to classify all contractors with multi-product lines or divisions as Class A cases, and has instructed the regional offices to request additional contractor information by product lines, divisions, etc.

The Board has been concerned about the increasing backlog (and especially the number of "over-age" cases) in the Eastern Board, and has had an Ad Hoc Committee studying the problem since early 1975. As a result of the Committee's recommendations, the Board has reassigned a number of cases from the Eastern Board to the Western Board in an attempt to equalize the backlog situation. However, the imbalance between regional offices is particularly acute in "over-age" cases (those assignments in process over 24 months). The Eastern Board had 160 over-age cases at the end of fiscal 1974, and 161 at the end of fiscal 1975; whereas, the Western Board had only 11 and 12 over-age cases, respectively, at the end of the two fiscal years. The Western Board historically has had fewer cases assigned because there are fewer corporations subject to renegotiation in the Western section of the country than in the East. The employment at the end of fiscal 1975 was 55 at the Eastern Board and 31 at the Western Board.

Since there are more contractors located in the Central and Eastern part of the United States, it has been suggested that the Eastern Regional Board be divided into, say, two or three regional offices, with one office located in the Northeast, one in the Southeast, and one in the Central area of the United States. In order to determine a proper geographic division of any additional regional offices, however, it would be necessary to pinpoint the number (as well as size) of contractors subject to renegotiation in the various regions of the nation. This information has not yet been developed.

The question of whether to give the Regional Boards more discretion to finalize cases or to reserve this authority entirely for the Statutory Board appears to need further study. The Joint Commit-

tee staff did not receive sufficient input on this question during its review of the renegotiation process to make a specific recommendation as to which direction the Board should go. The Joint Committee staff understands that the Board has a management study under way to evaluate the Board's organization. In addition, it would seem advisable to review the Board's field organization further in view of the later staff recommendation to have the Board evaluate the possible impact of applying the Administrative Procedure Act to the operations of the Regional Boards. (See, also, discussion under "Contractor Appeals Procedure" below.)

Staff Recommendations and reasons

While it is probable that the Board needs more regional personnel (and possibly additional offices), the Board needs to have additional time to adapt to any legislative changes and to evaluate the resulting impact on procedures and workload. In view of the staff's recommendation for the Board to review the possible application of the Administrative Procedure Act, (under "Contractor Appeals Procedure," below), the staff suggests that such a review include the possible impact on the regional board procedures and organization. The staff further suggests that the Board be directed to report directly to Congress not later than June 30, 1976, on the need for additional regional offices to adequately and expeditiously process cases.

The only existing penalties for late filing of statements and other required information are the criminal penalties set forth below, and in order for the penalties to be asserted it is necessary for the Government to prove that the nonfiling or misstatement was done willfully. This creates a significant evidentiary problem for the Government. Thus, the basic issue is whether to provide civil penalties to discourage late filing of returns or delaying the submission of requested financial information.

M. PENALTIES FOR LATE FILING

Present Law

As has already been noted, Section 105(f) of the Act sets minimum amounts of renegotiable business (the statutory "floor") above which a contractor or subcontractor is required to comply with the filing requirements of the Act. The present statutory floor is $1,000,000 on a fiscal year basis for contractors and subcontractors in general (and $25,000 in the case of brokers and sales agents). Section 105(e)(1) of the Act provides that every contractor or subcontractor to whom the filing requirements apply shall, in such form and detail as the Renegotiation Board may by regulations prescribe, file a financial statement setting forth such information as is required by the regulations. The statement is due on or before the first day of the fifth calendar month following the close of the contractor's fiscal year. (Extension of the filing deadline is available and is often granted—such as when the contractor receives an extension of the due date for filing the Federal income tax return.)

It is further provided that the Board may require any person having renegotiable business (regardless of whether he is required to file a financial statement) to furnish additional information in order to enable the Board to fulfill its obligations under the Act.

Finally, the Act provides criminal penalties to the effect that any person who willfully fails or refuses to furnish information or who knowingly furnishes false information shall, upon conviction, be punished by a fine of up to $10,000 or imprisonment of up to one year, or both. However, there are no civil penalties for late filing of required returns nor for delays in submitting requested financial information.

Proposals

Previous congressionally-sponsored studies

Neither the 1971 Government Operations Committee report nor the 1972 report of the Commission on Government Procurement contained recommendations concerning the penalty question.

The GAO, in its 1973 report, recommended that the Renegotiation Act be amended to provide reasonable civil penalties for failure to file reports required by the Act; and suggested that the penalty be a fixed amount if no excessive profits are determined, and a percentage amount equivalent to interest if there were excessive profits.[1] The GAO also recommended that failure to complete the renegotiable business question on income tax returns should be subject to an Internal Revenue Service penalty and that this matter should be pursued with the IRS.[2]

The third recommendation of GAO concerned civil penalties for the failure of contractors to furnish data or information required by the Board (other than filings of financial statements). The recommended penalties in this situation would be a fixed amount for each failure to furnish data, similar to penalties set forth in the Internal Revenue Code.[3] (The presumption in this case would be in favor of the Government and the contractor would have the burden of proving that its failure to submit the information was due to reasonable cause.)

Current congressional proposals

The Burton bill (H.R. 5940) would increase the existing maximum criminal penalties to a $50,000 fine and imprisonment for up to three years (or both).

The Minish bill (H.R. 9534) proposes to impose civil penalties of $500 per day (up to a maximum of $500,000) for "knowingly" failing or refusing to file required statements or data; further, the bill would increase the criminal penalty to $50,000 or one-year imprisonment (or both) for "knowingly" furnishing false or misleading statements or data.

Renegotiation Board

In its September 4, 1975 legislative proposals, the Renegotiation Board recommended that the Act be amended to provide for civil penalties of $100 per day for late filing of financial statements, up to a maximum of $100,000 for any fiscal year. It was also recommended as a conjunctive measure that the Board be empowered to impose similar penalties on contractors who fail to provide requested data and information.

Industry Representatives

The majority of the respondents from industry who submitted recommendations to the Joint Committee staff were of the opinion that

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[1] GAO Report (1973), p. 4.
[2] *Ibid.*
[3] *Ibid.* See, e.g., Code section 7269, which provides for a civil penalty of up to $500 for the failure to produce records in an estate tax matter.

civil penalties should be instituted for late filing of financial statements and other reports. Some recommended that civil penalties should be assessed only if the failure to file was "willful." None of the industry respondents expressed a recommendation on the advisability of having civil penalties for the failure to supply data and other information.

Other proposals

A former Chairman of the Renegotiation Board recommended providing civil penalties for failure to make timely reports.

Staff Analysis

It is clear that the existing provision for criminal penalties does little to encourage contractors to file reports on a timely basis or to enable the Board to receive a timely response to its requests for other necessary information. For example, the 1973 GAO report notes that only 124 cases had been referred to the Department of Justice through June 7, 1964 and that only one case had been referred to Justice since 1964,[4] despite the fact that failure of contractors to make timely filings has been and continues to be a significant problem. For example, the GAO Report indicated that during fiscal 1972, 85 of the 178 (or 48 percent) refund determinations made by the Board involved delinquent filings.[5] The primary difficulty with imposing the criminal penalties is the requirement that the Government prove the contractor's failure to file was "willful."

As Chairman Holmquist remarked in his testimony on July 29, 1975, to the Subcommittee on General Oversight and Renegotiation, the failure of the criminal penalty to provide a meaningful inducement for timely filing enables contractors to "delay an eventual determination of excessive profits and thereby obtain interest-free use of the Government's money for an indefinite period." [6]

In connection with the proposed civil penalties, it is argued that it is necessary to provide the Board with a discretionary power to refrain from assessing the penalty where the contractor is able to show it had reasonable cause for failure to make a timely submission of required reports or information. This could occur, for example, in the case of a third or fourth tier subcontractor who is not aware that its subcontract arose under a prime contract which is subject to renegotiation, and that it is therefore required to submit a filing to the Renegotiation Board.[7]

It also appears that the Board could improve its system of identifying contractors and subcontractors who are subject to the filing requirements, and therefore cause these companies to be aware of renegotiation requirements. There are two primary systems for identifying contractors subject to the Act, and the Board presently relies to some extent on both systems. The first is a system of self-identification where contractors and subcontractors are directed to indicate on their Federal corporation and partnership income tax re-

[4] The GAO report (p. 12) also notes that one referral remained open at the time of their report. The Joint Committee staff has been informed that the Department of Justice has declined to prosecute this case, and that no additional referrals have occurred.

[5] GAO Report (1973), p. 13.

[6] Hearings. Subcommittee on General Oversight and Renegotiation, p. 312.

[7] Section 104 of the Act requires that there be included in each prime contract, clauses which, in effect, suffice to inform the contractor that the contract is subject to renegotiation and that the prime contractor include clauses in its subcontracts sufficient to give first-tier subcontractors similar notice. Although the language of Sections 104 and 103(g) of the Act and Renegotiation Board Regulations, § 1452.4, could be interpreted to extend this requirement to succeeding subcontract levels, it is not clear whether this is in fact required or whether it actually occurs in practice.

turns the amount of sales which were subject to the Renegotiation Act. The information could then be supplied to the Board. However, this approach has not been entirely successful. Contractors often do not indicate whether they had any renegotiable business and the Internal Revenue Service seldom verifies the contractor's reply or penalizes the contractor for failing to answer the question on the tax return.

The other identification system used by the Board basically involves identifying contractors subject to the Act by information it is supplied by the contracting agencies and other contractors. Under this system, the Board receives from at least some of the contracting agencies a list of contracts awarded during the fiscal year and contractors who file with the Board are requested to supply the names of subcontractors with whom they did business of $500,000 or more under renegotiable Government contracts.

There is a shortcoming in each of these two types of identification systems. For example, the information supplied by contracting agencies is provided in terms of contracts awarded while the renegotiation filing requirements are measured by the contractor's "renegotiable receipts or accruals." The contractor's reports on major subcontractors are, like the IRS information, seldom audited. In addition, there is in each of these systems the problem of accumulating the renegotiable business of one contractor or subcontractor from several different departments or agencies.

It is the staff's conclusion that the potentially most viable system for identifying contractors subject to the filing requirements of the Act is one which relies upon payment information from the contracting agencies. These systems could possibly be amplified by requiring prime contractors to supply either the Board or the contracting agency with the amounts of payments to first-tier subcontractors performing under the prime contract. The Board could be requested to study this type of system in order to tighten its identification procedures.

Staff Recommendation

The staff recommends that civil penalties of $100 per day be set for late filing of required financial statements (up to a maximum of $100,000) for any given year's return, and that similar penalities be provided for failure to provide requested data and information. However, it is further recommended there be procedures for an abatement of a penalty for reasonable cause and for appealing such a penalty in court.

N. SUBPOENA POWER

Present Law

The Renegotiation Board has no subpoena power under present law.[1] However, section 105(e)(1) of the Act [2] provides a fine of up to $10,000, or up to a year in prison, or both, for anyone who "willfully" fails or refuses to provide required information or who "knowingly" provides false or misleading information.[3]

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[1] The general Government subpoena power provided by 5 U.S.C. 304 cannot be used by the Renegotiation Board because (1) the Board is not an Executive Department listed in 5 U.S.C. 101; (2) it is not a claim against the Government that is involved, but rather a claim by the Government (although the Government is nominally the defendant in the Court of Claims); and (3) the 5 U.S.C. 304 subpoena is for personal testimony, whether oral or written, whereas the Board seeks financial data (i.e., books and records).

[2] This provision was added in 1956 by Public Law 870 (84th Cong., 2d sess.).

[3] A conviction has never been obtained under this subsection. The Board maintains it is too difficult to prove beyond a reasonable doubt the intent necessary for conviction.

The issue is whether to grant subpoena power to the Board for books and records. It has been suggested that giving the subpoena power to the Renegotiation Board will lead to abuse or excessive use of that authority. On the other hand, it has also been asserted that the Board needs the subpoena power to perform its functions, particularly in facilitating timely receipt of requested financial information from contractors.

Proposals

Previous congressionally-sponsored studies

The three previously-mentioned reports did not discuss the question of the Board's need of subpoena power. (However, the GAO recommended "that the Congress revise the penalty provision to hold contractors responsible for furnishing all data required by the Board and to have contractors show reasonable cause why they did not furnish the data.")[4]

Current congressional proposals

The Minish bill (H.R. 9534) proposes to grant subpoena power to the Board (Chairman or any Board Member), with enforcement in U.S. District Court.

Renegotiation Board

The Board's 1975 legislative proposal again includes a recommendation that the Chairman (or his authorized agent) be given the authority to issue subpoenas *duces tecum* (subpoenas for books and records, as opposed to a subpoena to compel personal testimony), with enforcement in U.S. District Court. The Board first made this proposal in its 1974 legislative proposals to the House Committee on Ways and Means.[5]

Industry Representatives

Recommendations of industry representatives generally were that the Board should not be given the subpoena power. However, one accounting consulting firm suggested that the subpoena power be given for use only in extreme circumstances.

Other proposals

A former Chairman of the Renegotiation Board recommended that the Board be given the subpoena power.

Staff Analysis of Proposals

Recommendations regarding the subpoena power appear to depend upon the proposer's views of whether the Board needs the power, of whether there might be abuse of the power, and, if both of these views are affirmative, of which is the overriding factor. As previously mentioned, one accounting consulting firm suggested allowing the Board to use the power only under extreme circumstances, but it appears impractical to attempt to provide legislation taking into account all the various circumstances arising in the future that might be deemed "extreme."

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[4] GAO Report (1973), p. 4.
[5] Hearings before the House Committee on Ways and Means, 93rd Cong., 2d sess., May 14, 1974.
[6] *Ibid.*

Since the criminal penalty of present law for failure to disclose information to the Board appears to be unenforceable, the Board has no effective means of compelling disclosure of information that may be crucial to enable the Board to make accurate determinations of excessive profits. However, information possessed by the Board is available to the public under the Freedom of Information Act. This imbalance could be adjusted by giving the Board subpoena power, with statutory requirement that the U.S. District Court to enforce the subpoena. A specific direction (contained in the subpoena) to a specific person to produce specific information, a failure to produce being punishable as contempt of court, would make available to the Board information necessary to enable it to perform its function.

Furthermore, the staff has been informed by the Board that contractors are occasionally reluctant or tardy in furnishing information, or may furnish inadequate information, in both the renegotiation phase and even in the litigation phase of renegotiation cases. Of course, the Board needs full information to make accurate determinations of excessive profits. In cases that have progressed to litigation, it is especially beneficial if as much information as possible has been developed during the renegotiating process in view of the shift of the burden of proof to the Government with the shift of jurisdiction from the Tax Court to the Court of Claims. In trial lawyers' parlance, the evidence in renegotiation cases tends to be "controlled" by the contractors, and the shift of the burden of proof to the Government has made it additionally difficult for the Government to amass the evidence necessary for it to prove its case.

Staff Recommendations and Reasons

The staff recommends that the Board be given subpoena power for books and records (the subpoena *duces tecum*), with enforcement through a Federal District Court if the contractor for any reason fails to obey the subpoena. Further, the staff recommends that only a majority of either the Statutory Board, a "division" of the Board, or of a regional board be authorized to issue a subpoena. The penalty for failure to observe the subpoena should be a civil contempt-of-court penalty. Thus, the staff believes that no specific penalty for failure to obey the subpoena need be legislated.

The staff has discovered no basis for believing there is any greater possibility of abuse of the subpoena power than exists in any of the other Government agencies that have the subpoena power, such as the Internal Revenue Service, the Federal Trade Commission, or the Securities and Exchange Commission.

At present. Board proceedings are not adversary proceedings. The Board develops its information from unsworn representation, not personal testimony. Resultingly, the subpoena power need extend only to records, not to personal testimony. Of course, this suggestion would have to be reconsidered if the Administrative Procedure Act were extended to Board proceedings.

The penalty for disobedience of the subpoena should be a civil sanction, whereby the person disobeying the subpoena may win his release from imprisonment (or such other punishment as may be imposed by the court) by compliance with the subpoena. Such a civil sanction is actually more flexible and is not subject to the limitations on amount of fines and length of imprisonments that would be contained in any

predetermined, statutory (criminal) sanction. Furthermore, in a case involving a predetermined penalty in which the defendant might be sentenced to imprisonment for in excess of 6 months, a trial by jury could be claimed, thus further delaying contractor compliance and efficient renegotiation administration.

The criminal penalty of present law should be retained for willful and flagrant failures to provide information requested by the Board in instances in which the subpoena power is not used. This might occur, for example, in cases in which false or deceptive information is provided, as opposed to cases in which a Board request is rejected or ignored.

In view of the present provisions of law allowing attorneys of the staffs of the Securities and Exchange Commission and of the Federal Trade Commission to seek enforcement of their subpoenas in court, the staff has considered recommending allowing this permission to be extended to attorneys of the Renegotiation Board staff. In support of this proposition is the possibility that it would avoid the delay involved in requiring the Department of Justice attorneys to study the case in order to reach an independent judgment on whether enforcement of the subpoena should be sought. However, the staff recommends traditional enforcement of the subpoena through the Department of Justice, both because there is no basis for assuming significant delay on the part of the Department of Justice, as well as because the resulting requirement of an independent assessment of the grounds for the subpoena by the Department of Justice should eliminate whatever realistic possibility of abuse may exist in extending the subpoena power to the Renegotiation Board.

The staff has noted objections that the Board will not be able to make use of the subpoena power unless the Board's legal staff is increased. It is impossible to evaluate this argument except through study of the Board's actual experience in the use of the subpoena power. However, it seems likely that an increase in the Board's legal staff would facilitate its use of the subpoena authority.

O. INTEREST CHARGED ON DETERMINATIONS

It has been suggested that the accrual of interest beginning only after the Board's determination results in a windfall to the contractor since the date of the determination often occurs several years after the contractor receives the contract payments from which the excessive profits arise. The windfall is greater and the problem more acute in cases where a contractor, intentionally or otherwise, has failed to submit a timely report; this results in a further lengthening in the period of time between the contractor's receipt of the funds and the time at which the Board makes a determination and interest begins to run. Since the contractor has use of the funds for this period of time, it has been suggested that interest should accrue for the entire period, or begin to run at some time earlier than at present.

Present Law

Under Section 105(b)(2) of the Act, interest accrues on the Board's determinations of excessive profits. Generally, where excessive profits are determined by an order of the Board, interest begins to run from

the 30th day after the date of the order; where an agreement is reached with the contractor, interest begins to run from the date fixed for repayment by the agreement. In the case where excessive profits are redetermined by the Court of Claims, interest on the unpaid excessive profits continues to run from 30 days after the Board's order, with adjustments made to reflect alterations in the amount of the Board's determination by the Court of Claims. Section 105(b)(2) of the Act also provides that the rate of interest on such excessive profits determinations shall be a rate determined by the Secretary of the Treasury, taking into consideration current private commercial rates of interest for new loans maturing in approximately five years. This determination by the Secretary of the Treasury is made on a six-month basis effective on January 1 and July 1 of each year.[1]

Historically, a provision for interest on excessive profits determinations has been a part of the Renegotiation Act since it was first passed in 1951. However, it was originally provided at a set statutory rate which was, in 1951, set at 4 percent. This was amended in 1971 [2] to provide for the semi-annually adjusted rates presently in effect.

Proposals

Previous congressionally-sponsored studies

The General Accounting Office, in its 1973 report, noted that for the fiscal year 1972 almost one-half of the excessive profits determinations made by the Board involved delinquent filings, with two of these filings almost five years late.[3] It was also noted that the Government would have recovered over $450,000 (at 4 percent interest) if late filers had been charged interest on the excessive profits for the time the filings were late. Although the GAO did not recommend interest per se, it did recommend a penalty provision which is, in effect, interest measurable by the amount of excessive profits eventually determined and by the period the contractor's financial report was filed late.

Neither the House Committee on Government Operations nor the Commission on Government Procurement made a specific recommendation regarding amendments to the provision for interest on excessive profits determinations.

Current congressional proposals

The Burton bill (H.R. 5940) would charge interest from the due date of the contractor's financial statement for the fiscal year.

The Minish bill (H.R. 9534) would change the basic period for charging interest so that it would commence the day after the end of the fiscal period under review.

Renegotiation Board

In 1975 legislative proposals the Renegotiation Board recommended that the Act be amended to provide for interest on excessive profits determinations for periods during which the contractor had use of the excessive profits because of its failure to file reports on time or to comply with a Board request for information. (This recommendation was in addition to the recommendations that civil penalties be provided for failures to file timely reports and to submit requested information.)

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[1] The rate of interest for the period from July 1, 1975 through Dec. 31, 1975 (published in the *Federal Register* of June 20, 1975) is 8⅞ percent.
[2] Public Law 92–41, § 2, 85 Stat. 97.
[3] GAO Report (1973), p. 13.

In 1974, the Board recommended that interest commence one year following the due date of the filing (plus extensions granted).[4]

Industry Representatives

Industry representatives who expressed a recommendation on this issue were generally of the opinion that no change should be made in the existing interest provision. The minority of commenators who favored an expanded interest rule recommended only in situations where there was late filing or willful late filing of the returns, in which event the interest rate would be applied on the excessive profits only for the additional period of the late filing. Under this proposal, there would be no interest for the period during which the Renegotiation Board had the contractor's case under consideration. One industrial group pointed out that there is frequently a delay of two years or more from the filing of the original return until the Board enters an order determining excessive profits, and because such a delay is frequently the responsibility of the Government, it is inequitable to require a contractor to pay interest in these circumstances.

Staff Analysis of Proposals

It is clear that the long and sometimes very lengthy periods of time between the end of the contractor's fiscal year and the date when the Board makes a determination provides the contractor with a significant benefit through the interest-free use of the excessive profits during this period. It also appears inequitable, however, to charge the contractor interest for periods the Renegotiation Board has itself delayed the making of a determination on the contractor's case.

For these reasons, an alternative to the present timing of interest that appears to be fair to the contractor would be to commence the interest after the time when the contractor is notified that an excessive profits determination is recommended by a Regional Board. This is the first time the contractor is informed that he may have to refund excessive profits to the Government. However, it also appears reasonable to have the contractor bear the burden for any delays it has caused the Board in reaching determination of excessive profits. To reflect this policy, interest could be required on excessive profits for the period the contractor was late in filing returns or supplying requested information pertaining to the year for which the excess profits were determined.

Those who wish to commence interest on excessive profits determinations at an earlier time than at present, point out that interest imposed by the IRS on income tax deficiencies (under sections 6601 and 6151 of the Internal Revenue Code) generally runs from the due date of the tax return. On the other hand, others note that income tax assessments are precisely and more quickly determined than are renegotiation excessive profits determinations.

Staff Recommendation

The staff recommends that on excessive profits determinations, the interest charge commence 30 days after a regional board has issued either a final opinion or has notified the contractor of its recommendation of an excessive profits determination. In addition, it is recom-

[4] Hearings before the Committee on Ways and Means, 93rd Cong. 2d Sess., May 14, 1974.

mended that interest should be charged for previous periods where the contractor has delayed renegotiation because of failure to file returns or submit requested information on a timely basis.

P. CONTRACTOR APPEALS PROCEDURE

In general, the principal issue involves the adequacy of existing procedures with respect to (1) the question of due process for a contractor, including his rights concerning procedural matters and to be fairly informed of the reasons for a finding of excessive profits, and (2) the question of the cost imposed in connection with renegotiation proceedings.

Present Law

Under Section 107(d) of the Act, the Board is authorized to delegate functions, powers and duties to any agency of the Government, including an agency established by the Board. The Board now has two Regional Boards, and has delegated certain functions, powers and duties to them.[1] Further, the Chairman of the Board may divide the Board into divisions of one or more memmerse to consider cases (Sec. 107(e) of the Act).

Under Section 111 of the Act, the functions exercised by the Board are generally excluded from the Administrative Procedure Act (other than section 3 thereof, those provisions relating to freedom of information).

Under Section 107(e) of the Act, the Board may "review" any determination in any case not initially conducted by it, on its own motion or, in its discretion, at the request of the contractor or subcontractor. Upon review, the amount of excessive profits determined by the Board may be less than, equal to, or greater than, that determined by the agency whose action is reviewed.

With respect to a so-called "Class B" case (generally, renegotiable profits of $800,000 or less reported by a contractor), a Regional Board is authorized to issue a clearance (including a Final Opinion) that excessive profits were *not* realized,[2] or to execute an agreement as to an excessive profits determination and issue a Final Opinion with respect to such excessive profits.[3] All other cases must be reassigned from a Regional Board to the Statutory Board for further proceedings and final disposition.

Under Section 105(a) of the Act, the Board is required to "endeavor" to reach agreement with a contractor for the elimination of excessive profits. If an agreement is not reached, the Board shall issue and enter an order determining the amount of excessive profits. Whenever the Board makes a determination of excessive profits, the Board must prepare and furnish the contractor with a statement of the determination, of the facts used as a basis for the determination, and the reasons for the determination if the contractor requests the statement.

An outline of the procedures applicable to the Board and Regional Boards is set forth below. Under Section 108 of the Act, a contractor may petition the Court of Claims for a redetermination of excessive profits if the Board has issued an order determining excessive profits.

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[1] RB Reg. §§ 1451.3 and 1472.3 *et seq.*
[2] RB Reg. § 1473.2(b).
[3] RB Reg. § 1474.3(c).

The proceeding before the Court of Claims is not treated as a "review" of the Board's determination, but rather is treated as a proceeding *de novo*. The court may determine excessive profits as an amount either less than, equal to, or greater than the amount determined by the Board (or none at all). Under Section 108A of the Act, the decisions of the Court of Claims are subject to review by the Supreme Court upon certiorari.

OUTLINE OF BOARD PROCEDURE

A. Procedure by Regional Board

If a case is assigned to a Regional Board, a contractor is notified that the case has been assigned, and that renegotiation proceedings have been commenced.[3] The Regional Board staff assigned to the case will then examine the contractor's renegotiation filing and determine what additional information is needed. Requests for additional information from the contractor may be made by the Regional Board staff. Under the regulations, provision is made for preliminary meetings concerning the information requested.[4] The regulations further provide that the contractor is "entitled" to submit such other information as the contractor may wish to have considered by the Regional Board. Further, the contractor will be afforded a reasonable opportunity to present written or oral arguments to the Regional Board staff in support of its position on disputed issues or matters.[5] Provision is also made for plant inspection in an appropriate case, with the consent of the contractors.[6]

If a clearance recommendation is not made to the Regional Board by its staff assigned to the case, the following reports or information will be furnished to the contractor at the appropriate stage of the case:

(1) An accounting report, setting forth relevant financial and accounting information, with a request for the contractor's concurrence (or objections), and comments;[7]

(2) A renegotiation report, setting forth an analysis and evaluation of the case and a recommendation with respect to the amount of excessive profits;[8] and

(3) Copies of performance information secured by the Regional Board staff from the appropriate procuring agency or a prime contractor in the case of a subcontractor.[9]

During the course of the proceedings by the Regional Board or its staff, the contractor also has an opportunity to present his position at the following meetings or conferences: (1) after the renegotiation report has been furnished, a "renegotiation conference" will be held with the contractor and the Regional Board staff assigned to the case,[10] and (2) the contractor is entitled to meet with a "panel" of the Regional Board.[11]

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[3] RB Reg. § 1472.2.
[4] RB Reg. § 1472.3(a).
[5] RB Reg. § 1472.3(b).
[6] RB Reg. § 1472.3(c).
[7] RB Reg. § 1472.3(e).
[8] RB Reg. § 1472.3(f).
[9] RB Reg. § 1472.7.
[10] RB Reg. § 1472.3(j).
[11] RB Reg. § 1472.3(l).

The Regional Board itself may determine excessive profits in an amount greater than, equal to, or less than the amount recommended by a "panel." [12] If the Regional Board finds that the contractor realized excessive profits, a Proposed Opinion will be issued stating the basis for the finding of excessive profits.[13] Thereafter, the procedure employed depends upon whether the contractor agrees with the finding and whether it is a so-called "Class B" case. If agreement is reached in a Class B case, the Regional Board will proceed to execute an agreement concluding the case. If an agreement is not reached or the case is a "Class A" case, the case will be reassigned from the Regional Board to the Board for further proceedings, in which case, a Regional Board Opinion will be issued stating the basis for the recommendation.[14]

B. Procedure by Board

Once a case is reassigned to the Board, the Board or a "division" of the Board will study the information and data assembled. Additional information from the contractor may be requested. The Board or division is not bound or limited by the evaluation or recommendation of the Regional Board.[15]

The contractor is afforded an opportunity to meet with the Board or division before final disposition of the case.[16] Prior to the meeting, the contractor is furnished with a "Notice of Points for Presentation" to enable the contractor to respond to issues or matters on which presentation is desired by the Board.

If the Board then finds that the contractor realized excessive profits, the Board will furnish the contractor with a Proposed Opinion.[17] Thereafter, if agreement is reached, the Board will proceed to execute an agreement and conclude the case (and issue a final opinion).[18] If agreement is not reached with the contractor, the Board will then proceed to issue a unilateral order in the amount of the excessive profits determination (and issue a Final Opinion).[19]

C. Freedom of Information Provisions

The regulations implementing the Freedom of Information Act (section 3 of the Administrative Procedure Act) provide for public inspection and copying of the following records: [20]

(1) Agreements determining excessive profits.
(2) Orders determining excessive profits.
(3) Statements of facts and reasons issued by the Board.
(4) Letters not to proceed.
(5) Clearances after assignment.
(6) Clearances without assignment when there has been express Board action.
(7) Clearances without assignment made pursuant to a delegation of authority.
(8) Decisions on applications for commercial exemption.
(9) Decisions on applications for new durable productive equipment exemption.

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[12] RB Reg. § 1472.3(m).
[13] RB Reg. § 1472.4(m)(3).
[14] RB Reg. § 1473.2(a) and 1475.3 pursuant to § 1477.3.
[15] RB Reg. § 1472.4(b)(1).
[16] RB Reg. § 1472.4(b)(2).
[17] RB Reg. § 1472.4(c)(3).
[18] RB Reg. § 1474.4.
[19] RB Reg. § 1475.4, pursuant to RB Reg. § 1477.3.
[20] RB Reg. § 1480.5.

(10) Decisions on applications for stock items exemption.
(11) Special accounting agreements.
(12) Interpretations.
(13) General Orders that affect the public.
(14) Administrative Orders that affect the public.
(15) Memoranda of decision.
(16) Summaries of Facts and Reasons.
(17) Final Opinions.
(18) Regional Board Opinions.

D. Statements and Opinions

Pursuant to the requirements under Section 105 of the Act that, at the timely request of the contractor, the Board issues statements of the facts and reasons for a determination, the regulations provide that the "statement" issued by the Board will contain: (1) an indication of the recognition given to the efficiency of the contractor; (2) a separate discussion of each of the other statutory factors; (3) accounting data or schedules; and (4) a discussion of any material issue of law or accounting raised in the proceeding and its disposition by the Board together with its reasons.[21]

In 1974, the Board amended its regulations to provide for the issuance of proposed and final opinions (formerly "memorandum of decision," and still earlier, "summary of facts and reasons"). These opinions are issued in cases where there is a clearance after assignment, an agreement with the contractor, or when a unilateral order is issued. Provision is also made for a Regional Board Opinion which is to state the basis for a recommendation of excessive profits. According to its annual report for 1974, the Board adopted the changes in regulations governing the issuance of opinion documents "in an endeavor to provide contractors and the public with more information regarding the basis for findings and determinations in renegotiating proceedings."

The regulations also provide that renegotiation settlements for prior years are *not* controlling precedents.[22]

Proposals

Congressionally-sponsored Studies

As noted above under "Statutory Factors", all three congressionally-sponsored studies recommended that the Board issue clearer guidelines concerning the application of the statutory factors.

Also, in 1970, the Administrative Conference of the United States made in the following recommendation:

> "The Renegotiation Board should improve the caliber of the Summary of Facts and Reasons and the Statement of Facts and Reasons furnished to a contractor. The Summary or Statement should contain a complete analysis and explanation of the manner in which the Board arrived at its determination and should reflect the data in the Board's files upon which it has relied. This could be readily accomplished if Summaries and Statements were principally based upon the internal reports and memoranda contained in the Board's files in each case. Information concerning third parties which otherwise would be privileged or confidential

[21] RB Reg. § 1477.4.
[22] RB Reg. § 1460.2(d).

upon which the Board has relied in reaching a determination should be included in a Summary or Statement of Facts and Reasons if the information can be disclosed without impairing its proprietary value or identifying its source."

These studies or reports did not make specific recommendations with respect to the appeals procedure within the Board or the precedential weight to be given by the Board to its opinions.

Current Congressional Proposals

The Minish bill (H.R. 9534) would remove language in section 105(a) of the Act that the Board is to "endeavor" to reach an agreement with the contractor.

Industry Representatives

Several industry respondents suggested the application of the Administrative Procedure Act to the renegotiation process.

In general, this recommendation related to the suggested need for due process for a contractor (i.e., a *right* to adversary hearings with appropriate evidentiary and procedural rules and the development of a record which forms the basis for an opinion that fairly informs the contractor of the findings of fact and law underlying the decision) at the agency level. It also related to the expenses imposed upon the contractor under the present procedures (especially those associated with the *de novo* trial by the Court of Claims, which is first level at which due process in a technical sense is provided under the present procedures).

Staff Analysis of Proposals

As conceived in 1951, the renegotiation process was essentially to be a rather informal process under which the Government and the contractor would "negotiate" to reach agreement for the elimination of excessive profits. In other words, the renegotiation process was to involve some "give and take" similar to that which occur in negotiating contracts in order to reach settlement or agreement between the parties. Unilateral determinations were to be made after the Board failed in its required "endeavor" to reach agreement. It was felt that proceedings that were formally on an adversary basis would not be conducive to a "settlement" or "agreement" approach. However, many would argue that in fact the posture of the Government and an affected contractor has for years been that of adversary parties even while maintaining the appearance of attempting to reach settlements by mutual agreement in proceedings which are on a nonadversary basis in a technical sense.

On the other hand, it might be argued that there is no need to employ more formal adversary proceedings because the contractor, in any event, may have his day in court by petition to the Court of Claims and because the trend of the Board's changes in the procedural rules has been to provide more openness and "due process". For example, the Board has prescribed rules (1) to make performance information available to contractors (prescribed in 1971), (2) to implement the Freedom of Information Act to make available decisions concerning contractors, and (3) to improve the quality of its opinions (prescribed in 1974).

It may well be that the increase in the case backlog is partially attributable to these procedural changes which were designed in part

to provide more fairness and openness in the renegotiation process. The proceedings for a case may now easily extend for several years, including proceedings at the Regional Board level and the Statutory Board level. Thereafter, preparation for a *de novo* trial with the Court of Claims is time consuming and expensive. Generally, the time for disposition of a case in the Court of Claims will be extended because evidentiary and discovery problems must now be resolved; economic analysis must be performed by persons who are to be expert witnesses; and a detailed audit of the contractor's books is usually performed by the FBI.

Among those familiar with the renegotiation process, there appears to be substantial agreement that there could be an improvement in opinions rendered by the Board. Moreover, it would appear that the Board is also concerned with this issue. Chairman Holmquist indicated to the Joint Committee staff that the Board discussed this issue at a Board meeting held in August 1975, with a concensus of opinion being evident that the caliber of its decisions could be improved by a better articulation of the economic analysis involved and the application of the statutory factors in reaching a decision.

As an illustration of the need for a better statement of reasons for decisions, in a Final Opinion issued on June 27, 1975, the Board disposed of the efficiency factor with one sentence: "The contractor met or exceeded delivery schedules with a quality product, and the Board considered the contractor efficient in the review year." Presumably, the contractor was rewarded for efficiency rather than being penalized since, after consideration of other factors, the contractor was left with returns on net worth and capital substantially in excess of comparable industry averages. However, due to the lack of specific discussion, a reader of this opinion would have great difficulty in getting a feel for the weight accorded to the contractor's efficiency. It could be argued that this void could be filled with a more thorough discussion, although short of a precise quantification of the dollar impact of the efficiency factor consideration upon the final amount determined.

If the Administrative Procedure Act were made applicable to the renegotiation process, the proceedings would become more structured and formalized (although agencies are required to afford parties an opportunity for settlement or adjustment of issues, 5 U.S.C. 554). The formalized procedures would apply to notice requirements. evidentiary matters, the taking of depositions and making of a record of the proceedings. Presumably, the opinions rendered would reflect a more complete development of the case record. In this regard, a body of case law might develop which would supplement the regulations and guidelines issued by the Board. As in the case of other agencies, independent hearing examiners could be used to render initial decisions to achieve as much impartiality as possible. Decisions by hearing examiners could be appealable to the Board.

It is evident that application of the Administrative Procedure Act could make the renegotiation process at the agency level more time-consuming and expensive. This would tend to seriously aggravate the case backlog problem which has developed under the existing procedures and staff level.

However, the time and expense incurred in connection with court review might be reduced if that review were in the nature of an appellate review of the Board's decision rather than a trial *de novo*. Such a change would be possible if the Board developed the kind of case record which would permit review only for mistake of law or the absence of substantial evidence of fact.

It appears that application of the Administrative Procedure Act would beneficially affect certain aspects of rengotiation and adversely affect other aspects.

Since it has not been requested to do so, the Board or its staff have not made any official recommendations or observations concerning the application of the Administrative Procedure Act to the renegotiation process.

Staff Recommendations and Reasons

The staff recommends that no change be made at the present time with respect to the contractor appeals procedure. However, the staff further recommends that the Board be directed to evaluate the effect of applying the Administrative Procedure Act to the Board (including possible application to regional boards), and to report its findings and recommendations directly to the Congress not later than June 30, 1976.

The staff is aware that application of the Administrative Procedure Act would beneficially affect certain aspects of renegotiation and adversely affect other aspects. The beneficial effects would include providing due process for contractors, requiring the development of case records, promoting the issuance of better decisions, and alleviating the costliness of litigation if the Court of Claims review were in the nature of an appellate review rather than a *de novo* trial. The adverse effects would include aggravating the case backlog problem (since development of the case record would be more time consuming) and increasing the costs of proceedings before the Board. In view of these considerations, the staff believes that the Board should be given an opportunity to study the impact of applying the Administrative Procedure Act to its proceedings, and to report its findings to the Congress.

Q. JURISDICTION OF RENEGOTIATION CASES

The principal issue is whether to retain jurisdiction of renegotiation cases in the Court of Claims. Proposals have been made that jurisdiction should be returned to the Tax Court in order to reduce the time involved in litigating renegotiation cases, as well as to strengthen the Government's position in this litigation since the burden of proof was switched to the Government when the Court of Claims assumed jurisdiction.

Present Law

Court jurisdiction over renegotiation cases has been in the Court of Claims since July 1, 1971.[1] Jurisdiction was transferred from the Tax Court for any case in which the time for filing a redetermination petition expired on or after July 1, 1971. Court review of renegotiation

[1] Public Law 92–41, July 1, 1971.

cases is *de novo*, meaning, in essence, that the case is tried anew, and is not merely a review of the Renegotiation Board proceedings.[2]

Proposals

Previous congressionally-sponsored studies

The GAO report noted that the shift of jurisdiction caused the burden of proof to shift from the contractor to the Government, and that Court of Claims pretrial procedures are "lengthier and costlier than those of the Tax Court." [3] However, the GAO did not believe the Court of Claims had possessed jurisdiction a sufficient time to allow the transfer of jurisdiction to that court to be evaluated.

Current congressional proposals

Neither the Burton bill nor the Minish bill mentions the question of court jurisdiction; however, the Minish bill proposes to place the burden of proof on the contractor, as the bill would amend the Act so that the Board's determination would be presumed correct when a case is appealed to the court.

Renegotiation Board

The Renegotiation Board concludes that jurisdiction over renegotiation cases should remain in the Court of Claims.[4]

Industry Representatives

Most industry representatives (including legal and accounting firms that represent contractors and subcontractors in renegotiation matters) recommend that jurisdiction remain in the Court of Claims.

Other Proposals

A former Chairman of the Renegotiation Board recommended that jurisdiction be returned to the Tax Court. Other observers, however, have recommended that jurisdiction be retained in the Court of Claims.

Staff Analysis of Proposals

The proposal that jurisdiction should be returned to the Tax Court is advanced primarily by proponents of strengthening the Government's position in renegotiation litigation. Contractors, however, usually urge that jurisdiction be left in the Court of Claims. (Several business representatives suggested informally that this is because the Court of Claims has the reputation of being more "equity-minded" and a more favorable forum for a private party in litigation with the Government.)

One argument frequently advanced for returning jurisdiction of renegotiation cases to the Tax Court is that the Tax Court's procedural rules, such as simpler and less extensive pretrial proceedings, allowed renegotiation cases to be litigated faster and less expensively. This argument overlooks the fact that the Tax Court is now a constitutional court, not an administrative tribunal, as it was in years prior to the transfer of jurisdiction to the Court of Claims. In keeping with its new status, the Tax Court introduced new procedural rules on Janu-

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[2] *De novo* redetermination proceedings were first provided by Section 701 of the Revenue Act of 1943, at which time these proceedings were placed in the Tax Court.

[3] GAO Report (1973), p. 39.

[4] Hearings Before the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing, 94th Cong., 1st sess. (Sept. 19, 1975).

ary 1, 1974, that are generally more sophisticated than its prior rules and which for the first time provided for discovery proceedings.

Furthermore, a vast amount of work has been expended by both the Court of Claims and by Justice Department personnel in forming procedures to adapt renegotiation litigation to Court of Claims practice. It appears that much of that work has now been completed, with the probable result of considerably quickening the litigating pace and reducing the pending workload of renegotiation cases.

Another argument for retransfer is that the burden of proof was on the contractor in the Tax Court, whereas the Court of Claims has placed it on the Government.[5] However, this problem could be more directly resolved by placing the burden in the Court of Claims upon the contractor by statute. Those who oppose placing the burden on the contractor assert that the indefiniteness of the statutory factors for determining excessive profits and of the renegotiation process in general would make the burden of proof an intolerable burden upon the contractor. Others maintain, however, that the burden should be on the contractor because he controls most of the financial and other data upon which a determination of excessive profits is based. A possible resolution of this dispute would statutorily define the financial information requirements a contractor should meet before he establishes the *prima facie* case which, even under the Court of Claims rules, the contractor must initially meet despite the fact the ultimate burden is upon the Government. (Such a statutory requirement should take into account the procedural accommodation of renegotiation litigation the Court of Claims has already made administratively and through case law.) Alternatively, Congress could require the Court of Claims to spell out such financial disclosure requirements by a special rule or rules of the court.

A primary argument for retransfer of jurisdiction to the Tax Court has been the assertion that Department of Justice settlements reached in the litigation stage have been less favorable to the Government than they were when jurisdiction resided in the Tax Court. The General Accounting Office has asserted that Justice Department settlements of renegotiation cases subsequent to the assumption of jurisdiction by the Court of Claims were for only 53 percent of the amount of the Board's excessive profits, whereas Tax Court settlements had been for 89 percent.[6] Figures supplied to the Joint Committee staff by the Renegotiation Board's Office of General Counsel, however, indicate that settlements in the Tax Court (under the Renegotiation Act of 1951) were for 71 percent of the Board's excessive profits determinations, and that settlements since the transfer to the Court of Claims (through June 30, 1975) have been for 53 percent. (If "dismissals" are lumped with stipulated cases, the comparative settlements have been: 84 percent for the Tax Court and 65 percent for the Court of Claims.)

There are a number of reasons, aside from the burden of proof question, why these percentages do not necessarily mean that the Court of Claims is a weaker forum for the Renegotiation Board than was the Tax Court. These reasons include the following:

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[5] *Lykes Bros. Steamship Co., Inc.*, v. *U.S.* 193 Ct. Cl. 312, 459 F.2d 1393 (1972).

[6] Testimony of Richard W. Gutmann, Hearings on Renegotiation Before the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Currency and Housing, 94th Cong., 1st sess., p. 76 (June 5, 1975).

1. There was a large backlog of renegotiation cases as of the July 1971 transfer from the Tax Court;[7] and many of the weaker of these cases, especially those that might have established undesirable precedents in the new court, were then settled for relatively low values.[8]

2. Several exceptionally large cases that were determined to be particularly weak from the Government's standpoint were carried over to the Court of Claims and soon settled for relatively low values.

3. Further, some cases with excessive profits falling between the old minimum refund level ($40,000) and the new level ($80,000) were sacrified for low settlements for the sake of consistency.[9]

Staff Recommendation and Reasons

The staff believes that the Court of Claims should retain jurisdiction over renegotiation cases.

The same reasons for transferring renegotiation to the Court of Claims appear to be valid reasons for retaining jurisdiction in that court. The Court of Claims, with the type of discovery proceedings designed to clarify complex financial and accounting issues, and with its background in procurement cases, appears to be the natural forum for renegotiation issues. The work that has now been completed by the Court of Claims in adapting its proceedings to renegotiation issues would appear to reinforce this conclusion.

R. BONDING REQUIREMENT

The principal issue is whether the bonding requirement under renegotiation appeals should be retained, modified or eliminated:

Present Law

Section 108 of the Act,[1] requires anyone filing a petition with the Court of Claims for a redetermination of a Renegotiation Board determination of excessive profits to file within 10 days thereafter a bond in the amount fixed by the court. Court of Claims Rule 26(b) requires that all such appeal bonds must be for 100 percent of the amount of the Board's determination (less the Federal tax credit due the petitioner under section 1481 of the Internal Revenue Code of 1954, if he eventually were to pay the entire amount of the Board's determination). The Court of Claims has recently held that its 100-percent bond requirement is to be applied to all cases, rather than on a discretionary case-by-case basis.[2]

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[7] This backlog apparently resulted for several reasons. One was the overall heavy Tax Court schedule. Another was a tendency by contractors to let cases languish in the Tax Court because of the low rate of interest (four percent) on eventually adjudged excessive profits. Some of these cases were dismissed in the Court of Claims after the Government agreed to waive the accumulated interest. (These cases, in which the interest was waived, were recorded as "dismissed" cases.

[8] That many of the cases carried over to the Court of Claims had relatively low value for the Government may be indicated by the fact that settlements were less favorable to the Government in the years immediately prior to the transfer of jurisdiction to the Court of Claims.

[9] The general minimum refund level was raised by the Board's regulations to $80,000 with respect to contractors' fiscal years ending after 1970. The change in the Board regulation itself was made in 1972.

[1] This section has been in the act since 1951. In 1956, however, there was an amendment intended to make it clear that the authority of the Board to execute upon its determination could be stayed only if the appeal bond were posted (Public Law 870, 84th Cong., 2d sess.).

[2] *Manufacturers Service Co., Inc.*, v. *United States*, No. 336–74 (Ct. Cl., June 25, 1975).

Proposals

Industry representatives

Industry representatives were the only ones to make proposals to the Joint Committee staff regarding the bonding requirement.

Several legal firms that represent companies before the Renegotiation Board recommended that the bonding requirement be eliminated. One of these suggested that if the requirement were not eliminated, it should at least be modified, as, for example, by requiring the bond only where the contractor's circumstances are such as to prejudice unfairly the Government's ability to collect any judgment it may be awarded.

Staff Analysis of Proposals

The fact that a contractor has made profits that the Board holds to be excessive would normally indicate that the contractor should be able to meet the appeal bond requirement. However, those who argue that the bonding requirement should be eliminated are concerned with exceptional cases in which the contractor does not have the liquidity to post the collateral (i.e., cash or Treasury securities) necessary for the bond by the time the case goes to appeal after the sometimes long renegotiation process before the Board. Another possibility for failure to meet the bond requirement might be an instance in which a corporation has distributed its assets to stockholders and gone into dissolution before notification of the Board's claim of excessive profits. Such a corporation may or may not be able to recover sufficient assets from its stockholders to meet the bond requirement.

It has been asserted that contractors who are unable to post the Court of Claims bond may thereby lose their opportunity to present their case under the rules of due process. It should be noted that the financial problem assertedly caused to contractors by the bond requirement is not the cost of the bond; but rather, it is the amount of the bond. Costs of a bond obtained from a bond surety vary, but one attorney who has represented contractors before the Board estimated an expected cost might be as low as one percent of the face amount of the bond, or even less. The hardship is caused because surety bonds must generally be fully collateralized. Resultingly, the amount of collateral required by the surety institution must be in the amount of the Board's excessive profits determination since the Court of Claims requires the face amount of the bond to be 100 percent of the amount of the determination, as discussed previously. Of course, in the case of a collateral bond posted directly with the Court of Claims, the amount posted also must be 100 percent of the amount of the Board's determination.

Others urge that the Government's interest in the amount of the Board's determination of excessive profits should be secured during the litigation against the possibility the contractor may suffer financial reverses making it impossible for him to pay the amount of any eventual Court of Claims judgment against him.

Those who favor eliminating or altering the bond requirement also have argued that it is an unusual requirement that is peculiar to renegotiation litigation. (However, a "supersedeas bond" is required, under Rule 73(d) of the Federal Rules of Civil Procedure, of any appellant who wants a stay of execution on a District Court judgment.) They also maintain it is unlikely that a plaintiff's assets will be

dissipated after litigation commences if they have not already been dissipated in the course of the long renegotiation process culminating in the Board's determination of excessive profits (prior to the petition to the Court of Claims).

The only precise alternative that has been offered by those opposed to the requirement is that the bond should be required only in cases where the Government's financial interest is in jeopardy. However, this may require those very contractors for whom the bond requirement is an undue hardship (i.e., those that may be forced to choose either to appeal or to go out of business) to be the only contractors who would have to post the bond.

Those who believe the bond requirement should be retained point out that nothing has changed the historical desirability of securing the Government's interest in the amount of a determination of excessive profits. On the contrary, they maintain, the longer length of renegotiation litigation since jurisdiction of renegotiation litigation was shifted to the Court of Claims in 1971 makes it more possible the contractor will be unable to pay a judgment against him. (The greater period of time spent in litigation since the shift of jurisdiction appears primarily attributable to the more extensive and elaborate discovery proceedings in the Court of Claims than had been provided in the Tax Court. As to the period of time in Court of Claims litigation, Government attorneys have suggested that an ordinary case may last three years, unless it is settled in the meantime.)

Staff Recommendation and Reasons

Recommendation

The staff believes that no change needs to be made in the present bonding requirement.

Reasons for Recommendation

In the case of *Sandnes-Sons, Inc.* v. *United States* (199 Ct. Cl. 107, 462 F.2d 1388 (1972)), the Court of Claims made it clear that it interpreted the Renegotiation Act as treating the Board's determination of excessive profits and the Court of Claims' *de novo* proceedings as "wholly separate and distinct legal operations, neither one having anything to do with the other." Resultingly, the judgment taken by the Department of Justice on the amount of the Board's determination if the contractor fails to post bond does not default the contractor. He may proceed nevertheless to a trial of his case on the merits in the Court of Claims. On the contrary, the court maintained that the Renegotiation Act would be unconstitutional if it had to be interpreted as destroying "the capacity of an indigent corporation to litigate further."

As a result of this case, the Department of Justice obtains a judgment for the bond amount if a contractor does not post bond, but it then works out a payment schedule on which the contractor may pay the judgment.[3]

[3] This apparently has been traditional practice. However, the rights of the contractor to litigate although he had failed to post bond was seemingly not clarified before the Court of Claims obtained jurisdiction of renegotiation cases because judgment for failure to post the bond, as well as collection assistance, was obtained by the Government in the appropriate United States District Court, while the renegotiation litigation proceeded in the Tax Court. When the Court of Claims assumed jurisdiction, however, it took over jurisdiction of Government claims for judgment for failure to post bond (as well as jurisdiction of the merits of the renegotiation case) because it had counterclaim jurisdiction, and it interpreted the Government's claim to judgment as a counterclaim.

The parties then litigate their case as the Government collects its judgment debt.[4]

It appears, therefore, that the bonding requirment does not prevent contractors from litigating their cases with the benefit of due process merely because they cannot post the required bond.

In its considerations of this point, the staff considered several alternatives. None of these, however, solved the problem of protecting the Government's interest against its loss of an excessive profits determination because of a contractor's financial reverses suffered during the litigation period, while simultaneously protecting the contractor's right to a trial with due process despite the bonding requirement. The alternatives considered would appear to give the contractor no more relief than the present system provides.

One alternative, for example, which was given study would require the Government to place a lien on all the contractor's assets if bond were not posted within a short period of time after the Board issued its determination. The lien would be automatic, and the Government would not need to obtain judgment on the amount of the determination. The contractor could litigate his case, however. To encourage contractors to post bond, under these circumstances, a penalty amounting to approximately the cost of a bond would be imposed upon any contractor who failed to post bond. This idea was abandoned, however, in view of the fact that the lien thus imposed on the contractor would place him under the same disadvantage that the judgment lien which arises when the Government takes judgment for failure to post bond under the present system; that is, the contractor may not, under either system, be able to obtain financing, because of the lien on his property, necessary to allow him to obtain credit to continue operations.

S. CARRYBACK OF LOSSES

AND

T. AVERAGING OF PROFITS

The principal issues concerning carryback of losses and averaging of profits are:

(1) Whether a carryback of losses should be permitted; and

(2) Whether averaging of profits over more than one year should be permitted in determining excessive profits.

Present Law

Under section 105(a) of the Act, excessive profits are generally determined by examining a contractor's financial position and the profits from government contracts taken as a whole for a particular fiscal year. In addition, the regulations setting forth general principles provide that consideration will be given to profits and losses in prior years only to the extent provided under the regulations. For most cases, the regulations provide that determinations of excessive profits will be predicated on the facts and circumstances of the year under review. Thus, as a general rule, losses or "deficient" profits of a preceding

[4] It has been suggested to the staff that a typical period for payment on a judgment obtained because of the contractor's failure to post bond is three years, on the premise that the average renegotiation litigation period is three years.

fiscal year will not be taken into account for purposes of determining if excessive profits exist in a subsequent year. This general rule is subject to certain limited exceptions.

With respect to the statutory factor relating to reasonableness of costs and profits, the regulations provide that the Board will give consideration to certain situations where a contractor had "deficient" profits on renegotiable sales in a year or years prior to the year under review.[1] This exception to the rule generally relates to situations where a contractor has incurred startup costs in the prior years. However, it must be established that the "deficient" profits in prior years resulted from nonrecurring costs in the early stages of production which relate to production in the year under review. Under this provision, deficient profits from a preceding year will be considered if labor costs were high in that year because of excessive defective work resulting from inexperienced labor, idle time and subnormal production occasioned by testing and changing methods of production, or the cost of training employees. In addition, high material costs due to abnormal scrap losses arising during the early stages of production would result in consideration of deficient profits for prior years. Further, consideration will be given to instances where deficient profits resulted in prior years from expenses incurred in the design of a product or of special tooling, in the planning of production processes and layout, or in rearrangement of the contractor's plant, when incurred for renegotiable business.

The regulations mentioned above were adopted by the Board in 1971 as a result of a recommendation made by the Senate Finance Committee.[2] The Finance Committee noted that a contractor may realize "deficient" profits in the early years of a contract as a result of high startup costs but realize substantial profits in later years which considered alone would be excessive. However, the Committee further noted that the profits for the subsequent year would often be quite reasonable if the early startup costs were considered. To eliminate inequities, the Committee therefore recommended that deficient profits attributable to startup costs be taken into account by the Board under the circumstances now described in the regulations.

In addition, another way in which costs and expenses for a prior year may be taken into account for a review year would be in accordance with a special accounting agreement entered into with the Board.[3] Under such an agreement, costs incurred in prior years may be in effect transferred to the review year if necessary to properly reflect profits realized on renegotiable business. Generally, such an agreement would have to be made in a prior year in order to affect the results for the review year. The Board also employs other methods to reflect costs of other years to avoid inequities of fiscal year renegotiation.

Including the special accounting agreement, the Board generally uses the following methods to adjust an inequitable effect of fiscal year renegotiation:

1. By special accounting agreement with the contractor, the Board may permit preproduction or startup costs incurred prior

[1] RB Reg. § 1460.10(b)(5).
[2] Senate Report No. 92–245, 92d Cong., 1st sess. (1971).
[3] RB Reg. § 1459.1(b)(2).

to the year or years of production to be prorated over the period of production.

2. By special accounting agreement with the contractor, the Board may permit a contractor to adopt for renegotiation purposes the completed contract method of accounting for certain contracts to be performed over a period of more than one fiscal year.

3. The Board may permit the use of the periodic estimate method of accounting employed by many large defense contractors (notably airframe and missile manufacturers) for Federal income tax purposes.

4. The Board may consider research and development expenses incurred in prior years when these expenses relate to sales in the fiscal year under review.

5. The Board gives consideration to evidence showing risks through actual realization of losses incurred by the contractor in performing contracts in other years similar to the contracts undergoing renegotiation.

6. The Board gives consideration under the risk factor, in the fiscal year under review, to the possible saturation of the contractor's market in subsequent years.

Section 103(m) of the Act provides for a renegotiation loss carryforward. Generally, a renegotiation loss may be carried forward to each of the 5 fiscal years following the loss year. The loss is first carried to the next succeeding fiscal year and the remainder to successive fiscal years until fully applied.

A related consideration concerns the treatment of contracts with price adjustment provisions. Generally, when a price revision precedes renegotiation, the amount of a price revision allocable to the fiscal year under review will be reflected in the renegotiable income of the contractor.[4] When renegotiation precedes price revision, provision is made for the portion of an anticipated price revision which is determined to be allocable to the fiscal year under review.[5]

However, recognition of a subsequent price revision would be made only if such revision is "anticipated" at the time the case is considered for renegotiation purposes. Thus, certain price redeterminations made after renegotiation is closed would not be taken into account in determining excessive profits. If this occurs, the Government would have in effect recovered twice for profits attributable to a contract, i.e., one recovery in the form of excessive profits by the Renegotiation Board and another recovery in the form of a price redetermination by the procuring agency.

Proposals

The congressionally-sponsored studies previously conducted did not contain a recommendation with respect to these issues. According to the testimony presented by Chairman Holmquist before the Subcommittee on General Oversight and Renegotiation on July 29, 1975, the Board does not have any recommendation with respect to these issues either.

Generally, industry representatives commenting to the Joint Committee staff indicated that the statute should be amended to provide

[4] RB Reg. § 1457.5(c).
[5] *Ibid.*

for loss carrybacks as well as loss carryovers. In a majority of such responses, it was recommended that the carryback provisions be patterned after the Internal Revenue Code provisions, i.e., carryback for 3 years and a carryforward for 5 years. One respondent recommended the allowance of "subnormal" profit carrybacks as well as loss carrybacks.

Several other commentators, however, were opposed to providing a loss carryback. It was suggested that allowing the carryback of losses would make a complex process more complicated.

On equity grounds, a majority of the industry representatives believe that averaging of profits should be provided under the Act. It was suggested that a mandatory or mechanical averaging provision would probably not work but that the Board could be generally directed to consider the profits or losses of other years in determining excessive profits for a review year.

Staff Analysis

Under present law, it is arguable that many inequities are attributable to fiscal year renegotiation and that these inequities are not adequately eliminated by the Board. The basic problem concerns a situation where profits reach a peak in one year and appear to be excessive when no consideration is given to other years where "deficient" or "inadequate" profits are realized. This situation could exist in the case of a single contract performed over a period of years or in the case of a series of two or more short-term successive contracts performed over a period of years. One industry representative has referred to taking excessive profits for a single year as "skimming off the cream."

In many cases, profits for a single year are apparently "excessive" because of an increase in the volume of business for that year, e.g., unit costs could be lower on an overall basis because fixed expenses are absorbed by a larger quantity of production. However, the regulations provide that, when the Government's demand has enabled the contractor to increase his sales without exceptional effort and without corresponding increases in costs, and decreased unit costs result, the government should normally get the "principal" benefit in more favorable prices or in renegotiation.[6]

In such a case, the contractor is entitled to a larger share of the benefit arising from increased volume if he establishes additional factors such as developmental contribution, added risk assumed, or additional capital investment. Short of these general considerations, little guidance is provided with respect to the treatment of profits attributable to volume increases and the extent to which results of lower volume years will be considered unless the specific situations recognized under the regulations exist (e.g., startup costs resulting in lower profits for a prior year).

In addition, there is no specific requirement that losses, "deficient" or "inadequate" profits attributable to idle plant be considered. Thus, there is no assurance that the expenses attributable to a plant facility held for defense production will be considered to any extent when it is placed into production for a later year when excessive profits may arise. Many would argue that it is unfair to ignore prior year's expenses attributable to idle plant when availability of production capacity is beneficial to the Government in time of an emergency.

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[6] RB Reg. § 1460.10(b)(3).

Although consideration might be appropriate under the risk factor, there is also no specific requirement that inflation-induced losses or "deficient" profits occurring in a subsequent year under a fixed-price contract be taken into account for a year in which excessive profits appear to have been made.

In each of the cases mentioned above, the essence of the objection is that it is unjust or unfair to take "excessive" profits from one year unless provision is also made for "deficient" profits in other years. Under present law, this problem is dealt with in a limited manner. In other words, the circumstances under which "deficient" profits are taken into account provide only a partial solution.

There would appear to be complex problems involved in formulating a precise or mechanical provision under which losses or deficient profits would be carried back. If such were the case, prior years would have to be reopened and the Board would probably have to review the prior years to the extent such that they could determine what amount of profit should be allowed. In essence, this might necessitate a complete review of a previously-closed case, resulting in the possibility of an increase in the already existing backlog of cases.

In addition, a mechanical loss or "deficient" profits carryback would complicate existing problems, e.g., calculation of the minimum refund level, profits by profit center, division, or product, and computation of the Federal income tax credit and State income tax adjustment. Many of these problems would also create complexities in the case of a mechanical "deficient" profits carryover.

It may be argued that the complexities mentioned above should not preclude an attempt to eliminate any inequitable effects of fiscal year renegotiation. As in the case of "excessive" profits, there would appear to be no formula for the determination of "deficient" profits that would be satisfactory in all cases. Thus, it may seem more appropriate to deal with this problem in a general way.

Under a general approach, it would seem necessary to deal with the problem of deficient profits in the same manner as the existing statutory factors deal with excessive profits. For this purpose, the term "deficient profits" would presumably mean profits which are below the norm for a contractor in a particular trade or business under the facts and circumstances of the case. However, it would seem appropriate to exclude consideration of "deficient" profits which are found by the Board to be attributable to inefficiency by the contractor. In addition, it would appear that the burden of showing that deficient profits were made in a fiscal year would have to fall upon the contractor.

Staff Recommendations

For the above-mentioned reasons—

(1) The staff recommends that loss carrybacks not be allowed; and

(2) The staff does not recommend the adoption of a specific formula for the averaging of profits. However, as noted under "Statutory Factors" above, the staff recommends that the "reasonableness of costs and profits" factor be amended to provide that, in determining excessive profits for a fiscal year, the profitability of the preceding three fiscal years and the next succeeding fiscal year be "considered" by the Board.

U. ANNUAL REPORT BY GAO ON RENEGOTIATION

The issue is whether to require by law that the operations of the Renegotiation Board be subject to an annual review by GAO, with an annual report of such review to Congress.

Present Law

There is no present requirement that the GAO review or report on the operations of the Renegotiation Board.

Proposals

Current congressional proposals

The only formal proposal that GAO conduct an annual review of the operations of the Renegotiation Board, and report annually to Congress, has been in the Minish bill (H.R. 9534).

Renegotiation Board

In testimony before the Minish Subcommittee on September 19, 1975, the Board indicated that they saw no need for a required annual review by GAO, as the GAO may review the Board's activities at any time.[1]

Industry representatives

In comments made to the Joint Committee staff, industry representatives generally felt that there was no apparent need to require an annual review by GAO.

Staff Analysis

As mentioned in previous discussions in this report, the GAO made a report to the Congress on renegotiation in 1973, entitled: "The Operations and Activities of the Renegotiation Board." This GAO report was the result of a request from the House Government Operations Committee as a followup to the Committee's previously-mentioned 1971 report: "The Efficiency and Effectiveness of Renegotiation Board Operations."

Further, the GAO is presently preparing a report (to be published soon) on the Board's determinations of excessive profits during fiscal years 1970–1973, to trace the cases back to pocurement to analyze the causes of the specific excessive profits.

The GAO is subject to the direction of Congress, and will conduct any reviews that Congress desires from time to time. In addition to congressionally-directed studies of Executive Branch activities, the GAO often initiates studies as part of its audit function. The GAO has indicated to the Joint Committee staff that it sees no need for legislation to direct it to conduct an annual review of the Renegotiation Board.[2]

Staff recommendation and reasons

The staff believes that there is no need to require the GAO to review and report on renegotiation on an annual basis, since the GAO will make whatever reviews and reports the Congress requests from time to time.

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[1] Hearings on H.R. 9534, House Subcommittee on General Oversight and Renegotiation (Sept. 19, 1975).

[2] Letter from the GAO to the staff of the Joint Committee on Internal Revenue Taxation, July 24, 1975.

APPENDICES

APPENDIX A

PRESS RELEASE

JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION, U.S. CONGRESS,
1015 LONGWORTH HOUSE OFFICE BUILDING,
Washington, D.C., June 11, 1975.

STAFF OF JOINT COMMITTEE ON INTERNAL REVENUE TAXATION INVITES COMMENTS IN CONNECTION WITH ITS STUDY OF THE RENEGOTIATION ACT OF 1951

The staff of the Joint Committee on Internal Revenue Taxation invites written comments from anyone interested in the renegotiation process and the activities and operation of the Renegotiation Board. The staff is conducting a study of the renegotiation process, pursuant to Public Law 93–368, which is to be submitted to Congress no later than September 30, 1975. In order for the comments to receive timely consideration in the staff study, the comments should be received by July 15, 1975.

Public Law 93–368 instructs the staff of the Joint Committee to determine if the Renegotiation Act of 1951 should be extended beyond December 31, 1975, and, if so, how the administration of the Act can be improved. The staff is specifically instructed to consider whether the exemption criteria and the statutory factors for determining excessive profits should be changed to make the Act "fairer and more effective and more objective." Further, the staff is to consider whether the Renegotiation Board should be restructured.

In conducting the study, the staff of the Joint Committee is directed by Public Law 93–368 to consult with the staffs of the Renegotiation Board, the General Accounting Office, the Cost Accounting Standards Board, and the Joint Economic Committee. In addition, the staff of the Joint Committee intends to consult with other governmental agencies covered by the Renegotiation Act (as well as those not presently covered), other congressional committee staffs that may have jurisdiction over agencies covered by the Act, the Office of Management and Budget (including the new Office of Federal Procurement), the Department of Justice (with regard to settlements of appeals and court cases), and those outside the Federal Government who are familiar with the renegotiation process.

Any individual, corporation, or organization with an interest in the operation of the Renegotiation Board, or with experience in the renegotiation process, is invited to submit written comments, giving their thoughts and recommendations of the major issues to be covered in the staff study listed below. (Other areas may be commented upon

also, such as the administrative procedures used by the Board, assignment of cases to the field, court proceedings, etc.) These comments are to assist the staff of the Joint Committee in conducting its study.

The staff requests that five (5) copies of each statement be sent to: Joint Committee on Internal Revenue Taxation, 1015 Longworth House Office Building, Washington, D.C. 20515.

Renegotiation Issues on Which Comments and Recommendations (Including Reasons) Are Requested for Joint Committee Staff Study

1. *Extension of Act.*—(a) Extend—permanent or temporary (how long); (b) not extend (e.g., is renegotiation needed today?).

2. *Coverage of Act.*—(a) No change; (b) cover additional agencies; (c) delete certain agencies; (d) extend to all Government agencies.

3. *Statutory factors.*—(a) Leave as is (and develop written guidelines); (b) minor revision (with written guidelines); (c) major revision (such as greater emphasis on return on net worth or capital employed, setting more objective criteria for the factors, etc.).

4. *Accounting standards.*—(a) Continue tax standards for allowability; (b) adopt Armed Services Procurement allowability standards; (c) follow financial accounting standards; (d) applicability of Cost Accounting Standards Board rules to renegotiate contracts.

5. *Exemptions.*—(a) Leave as is; (b) modify existing exemptions; (c) examine waiver of exemption provision; (d) remove certain exemptions, such as for (i) standard commercial articles and services, (ii) new durable productive equipment, (iii) competitively-bid construction contracts, (iv) oil and other minerals, (v) timber and certain other raw materials, (vi) certain subcontracts, (vii) other types of contracts, including stock items and certain permissive exemptions (such as for leases and for contracts performed outside the U.S.); (e) add new exemptions, such as for advertised fixed-price contracts or certain incentive-type contracts.

6. *Classification of contractor scales.*—(a) Leave as is (on an aggregate fiscal year basis); (b) product line renegotiation; (c) contract-by-contract (over some minimum amount).

7. *Floor level.*—(a) Leave floor at $1,000,000 ($25,000 for brokers); (b) raise the floor; (c) lower the floor.

8. *Minimum refund level.*—(a) Whether justified; (b) if so, at what level.

9. *Board structure.*—(a) Keep as is in Executive; (b) make it a more independent executive agency; (c) make it a congressional agency (similar to GAO).

10. *Board organization and membership.*—(a) Leave as is; (b) set terms for members, with limitation on number from any political party; (c) require some relevant experience; (d) provide more administrative authority for Chairman; (e) set some specific conflict-of-interest requirement.

11. *Board budget and staffing.*—(a) Adequacy of existing staff (such as in the screening and review processes); (b) need for additional staff; (c) development of research and planning staff.

12. *Board field organization.*—(a) Leave as is; (b) have field offices for contractor contact (audits and information gathering) but leave determination to National Office (similar setup as the SEC).

13. *Penalties for failure to make timely reports.*—(a) Provide for civil penalties; (b) modify or increase criminal penalties.

14. *Subpoena power.*—Provide for subpoena power.

15. *Interest charged on redeterminations.*—Assess interest where reports were filed late and excessive profits are determined.

16. *Contractor appeals procedure.*—Adequacy of present procedure.

17. *Justice Department settlements.*—Differences between Justice Department settlements and Board determinations.

18. *Court jurisdiction.*—(a) Leave under Court of Claims; (b) return to Tax Court; (c) other considerations (such as the bond requirement).

19. *Carryback of losses.*—Whether to allow.

20. *Averaging of profits.*—Whether to average profits over more than one year.

21. *Review and report by GAO.*—Whether to require annual review and report by the GAO of the activities and operations of the Board.

APPENDIX B

1975 PROPOSALS FOR REVISION OF THE RENEGOTIATION ACT: COMPARISON OF RENEGOTIATION BOARD, JOINT COMMITTEE STAFF, MINISH BILL (H.R. 9534), AND BURTON BILL (H.R. 5940)

Item	Renegotiation Board as Approved by OMB (along with Board recommendation, if different)[1]	Joint Committee Staff	Minish Bill (H.R. 9534)[2]	Burton Bill (H.R. 5940)
1. Exten[illegible]	[illegible]	[illegible]	[illegible]	[illegible] sec. 2
2. [illegible]	[illegible]	[illegible]	[illegible] coverage	[illegible] coverage.
3. [illegible]	[illegible]	[illegible]	[illegible] as [illegible]	No mention.
[illegible]	[illegible]	[illegible] CASB [illegible]	[illegible]	[illegible] CASB [illegible]
[illegible]	[illegible] Board [illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7. [illegible]	[illegible]	[illegible] Board	[illegible]	[illegible]
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]	[illegible]	[illegible] OMB and [illegible]	[illegible]	[illegible]
10. [illegible]	(1) 7-year staggered terms [illegible] President [illegible] 1, 2, 3, 4, 5, 6, or 7 [illegible] present members. (2) [illegible] terms [illegible] (3) Limit members from one political party to three. (4) Provide statutory administrative powers to Chairman. (5) Raise salary of Chairman to one level above other members.	(1) [illegible] staggered terms. (2) [illegible] than 6 months. (3) Presidential designation of Chairman. (4) Limit members from one political party to three. (5) Provide statutory administrative powers to Chairman; and (6) Raise salary of Chairman to one level above other members.	(1) 5-year staggered terms [illegible] with present members designated by the President for 1, 2, 3, 4 and 5-year terms beginning Jan. 1, 1976 (bill sec. 3(b)). (2) Appointments to fill vacancies are to be for unexpired term (bill sec. [illegible]). (3) No more than 3 members from the same political party (bill sec. 3(a)). (4) Give statutory administrative authority to Chairman, and designate him as "chief executive officer" (bill sec. 9).	(1) 5-year staggered terms (sec. 5[illegible]) with order of first terms of members as the President prescribes. (2) Appointments to fill vacancies are to be for unexpired term (sec. 5(a)).
11. Board budget and staffing (sec. 107[illegible] of act).	No mention	Provide sufficient staffing to reduce backlog and expedite handling of cases; also, increase staff in planning and research, economic analysis, screening, and legal.	No specific mention except for a general authorization of funds to carry out purposes of bill (bill sec. 12).	No mention.
12. Board field organization (see 107(b) of act).	No mention	Have the Board review field organization and report (by June 30, 1976) on need for additional regional offices as well as on possible impact of applying Administrative Procedure Act to regional boards.	No mention	No mention.
13. Civil penalties for late filing (Not in present act; criminal penalty for "willful" failure—see 105(e) of act).	(1) Civil penalties of $100 per day (up to $100,000) for failure to file (or late filing of) required financial data. (2) Similar penalties for not submitting requested data.	(1) Civil penalties of $100 per day (up to $100,000) for late filing of required financial reports. (2) Similar penalties for delays in submitting requested information.	(1) Civil penalties of $500 per day (up to $500,000) for "knowingly" failing or refusing to file required statements or data (bill sec. 6(a)); (2) Provides criminal penalties of up to $50,000 or one year prison (or both) for "knowingly" furnishing false or misleading statements or data (bill sec. 6(b)).	Increase criminal penalties to up to $50,000 and prison up to 3 years (sec. 6). (No mention of civil penalties). No mention.
14. Subpoena power (not in present act).	Provide subpoena power to the Chairman (or authorized agent) for books and records, with enforcement in District Courts.	Provide subpoena power for books and records to a majority of Board, of a "division" of the Board, or of a regional board, with enforcement in District Court.	Provide subpoena power for books and records or other relevant documents to the Chairman or any member of Board, with enforcement in District Court (bill sec. 10(a)).	No mention.
15. Interest charged on redeterminations (see 105(b)(2) of act).	Charge interest for periods of contract or delinquency (late filings or delays in furnishing requested data).[4]	(1) Change basic period of charging interest so that it commences 30 days after a regional board makes a determination; (2) Also, charge interest for periods of contractor delinquencies in filing or supplying data.	(1) Change basic period of charging interest so that it commences the day after the end of the fiscal period under review (bill sec. 7); (2) The Secretary of Treasury is to set the interest rate on July 1 and December 31 of each year, taking into consideration commercial rates on new loans maturing in about 5 years.	(1) Commence interest on due date of filing (sec. 4(a)). (2) Same rate as under H.R. 9534 (see 4(a)).
16. Contractor appeals procedures (Sec. 111 of act exempts Board from APA, except for sec. 3).	No mention	Direct the Board to evaluate effect of applying Administrative Procedure Act to Board operations, and report findings by June 30, 1976.	No mention.	No mention.
17. Court of jurisdiction (see 108 of act).	No mention; thus, no change	Keep in Court of Claims rather than returning to Tax Court.	Keep in Court of Claims, but switch burden of proof from Government to contractor—i.e. the Board's determination of excessive profits is to be presumed correct (bill sec. 11(a)).	No mention.
18. Bonding requirement (sec. 108 of act).	No mention	No change in present practice.	No mention.	No mention.
19. Loss carryback (not in present act).	No mention	Do not permit carryback of losses.	No mention.	No mention.
20. Averaging of profits (not in present act).	No mention	Do not have a specific formula for averaging (but see above under statutory factors for consideration to be given to the profitability of 3 prior years and 1 succeeding year).	No mention.	
21. GAO review (not in present act).	No mention	No need to require an annual review as GAO will make reports as requested by Congress.	Require an annual GAO review of the Board's operations, with an annual report by GAO to the Congress (bill sec. 10(e)).	No mention.
Other items (not covered by Joint Committee staff recommendation):				
[illegible] 102 [illegible]	Delete requirement that the Board pay [illegible] witness fees for trial of cases, thus, allowing the Justice Dept. to pay its [illegible] its funds.	No mention.	Same as Board (bill sec. 11(b)).	No mention.
Re[illegible] excessive profits determina[illegible]	Have GAO and Treasury, rather than GSA, handle refunds of [illegible] where the Court of Claims [illegible] Board [illegible]	No mention.	No mention.	No mention.
[illegible]	Change [illegible] for annual report [illegible] to Apr. 1 [illegible] fiscal year.	No mention.	No mention.	No mention.
[illegible] 107 [illegible]	No mention	No mention.	Change name to "Excess Profit Recovery Board" (bill sec. 10(f)).	No mention.
Renego[illegible] 105 [illegible]	No mention	No mention.	Removes language that Board [illegible] endeavor to reach an agreement with contractor. This Board is to either enter into an agreement or issue an order. In the absence of a timely petition to the Court of Claims, the Board's determination is to be final and conclusive and not subject to review by any court or agency [illegible].	No mention.
[illegible]	No mention	No mention.	Requires detailed auditing by the Board or its authorized representative of every required financial statement. Provide access to books and records of contractor as needed. Upon request by the Board, any agency holding [illegible] to provide audit support to verify financial statements, as well as [illegible] the IRS [illegible] available for assistance (bill sec. [illegible]).	Authorize use of DCAA in making review of filings (sec. 7).
[illegible] Reports of [illegible] statements to [illegible] agencies [illegible] in present act.	No mention	No mention.	Require the Board to [illegible] 30 days after the end of the fiscal year a summary of each financial statement to the Government agencies involved with the contracts of the contractor (bill sec. 10[illegible]).	No mention.

[1] Mar. 27, 1975 letter to the Office of Management and Budget.

[2] Cosponsored by Mitchell (Md.), Derwinski, Hayes (Ind.), Gonzalez, St Germain, Evans (Ind.), and McKinney of S[illegible] [illegible] John Burton and Br[illegible].

[3] The Board has by resolution on Apr. 30, 1975 reemphasized its intent to [illegible] using authority to obtain and analyze financial data by product line, etc., in evaluating the return, but with final renegotiation to be on an overall basis.

[4] Interest now commences 30 days after Board issues an order or an agreement is reached.

OFFY

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OFFICE OF PLANNING AND ANALYSIS

Analyzes and evaluates the effectiveness of current programs and the planning of projected Board programs, including such matters as policies, standards, and criteria used in the renegotiation process; plans, initiates and conducts economic studies, analyses and surveys; prepares background material for, and a finished draft of, the Annual Report of the Board to the Congress.

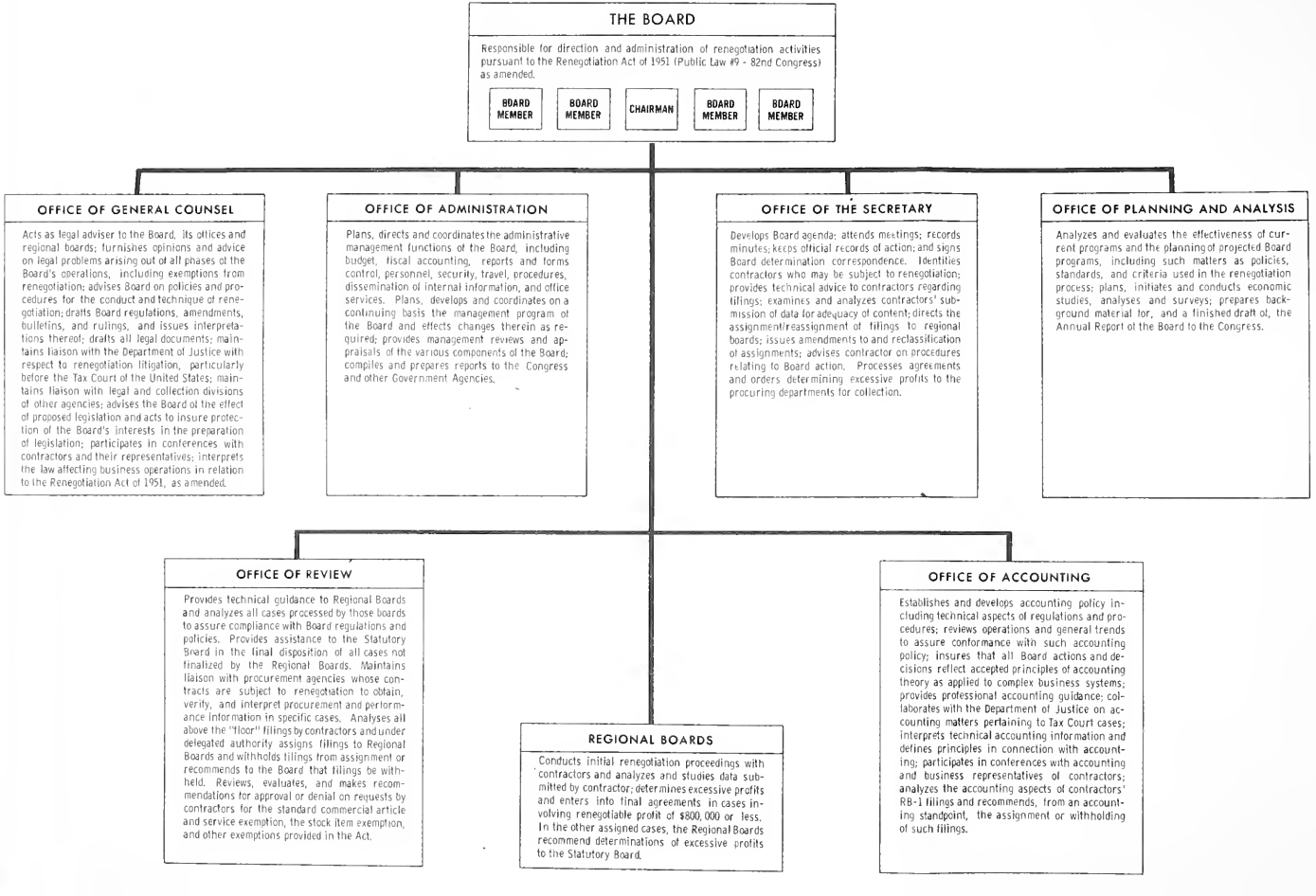
OFFICE OF ACCOUNTING

lishes and develops accounting policy in-
ng technical aspects of regulations and pro-
res; reviews operations and general trends
isure conformance with such accounting
y; insures that all Board actions and de-
ns reflect accepted principles of accounting
y as applied to complex business systems;
des professional accounting guidance; col-
ates with the Department of Justice on ac-
ting matters pertaining to Tax Court cases;
prets technical accounting information and
es principles in connection with account-
participates in conferences with accounting
business representatives of contractors;
zes the accounting aspects of contractors'
filings and recommends, from an account-
standpoint, the assignment or withholding
ch filings.

APPENDIX C-1

ORGANIZATION CHART OF

THE RENEGOTIATION BOARD



APPENDIX C-1

Reorganization at Renegotiation Board Headquarters Office

The Statutory Board approved the reorganization of the Headquarters on February 4, 1974. One purpose of this reorganization was to pinpoint responsibility for the major functions of receiving and examining contractors' filings and maintaining a surveillance over statutory completion and commencement dates. Also, a need existed to centralize, to the extent possible, responsibility for telephonic and written inquiries to contractors concerning their filings with the Board. It involved five Offices and was effected only after considerable study and evaluation.

The Offices of Assignments, the Secretary, Economic Advisor, Administration and Accounting were those involved in the reorganization. The Office of Assignments was originally charged with a variety of unrelated functions and areas of overlapping responsibility existed between the two Divisions of that Office and other Offices of the Headquarters. Responsibility was also divided between the Office of Assignments and the Office of Accounting with respect to the analysis of contractors' filings, particularly evaluations of segregation of sales and allocation of costs matters.

The sole responsibility for examinations of a professional nature were thus transferred to the Office of Accounting, along with the function of maintaining liaison with the Internal Revenue Service on renegotiation matters. Functions transferred to the Office of the Secretary were: the identification of contractors who may be subject to renegotiation; providing advice to contractors with respect to the preparation of renegotiation forms; the examination and analysis of contractors' data for adequacy of content; the assignment and reassignment of filings to regional boards; and the surveillance over statutory completion and commencement dates.

The development of an EDP system to use automated data in the renegotiation process, and for other purposes, became the responsibility of the Office of Administration. This was considered to be an administrative management function that provides services to the entire agency. The size and scope of the program precluded an in-house computer operation and it is to be performed on a time-sharing, contract basis by the Department of Agriculture.

The Office of the Economic Advisor, since its creation, was composed of a Director and a Secretary. While the Economic Advisor has always performed a variety of functions outside the field of economics, these were on an unofficial basis for which he received no formal recognition. The Board, therefore, abolished the Office of Economic Advisor and created the new Office of Planning and Analysis. It was given some responsibilities that were already being performed by the Economic Advisor as well as new and additional functions. New func-

tions include analyzing and evaluating the effectiveness of current programs, the planning of projected Board programs, and the development of standards and criteria for use in the renegotiation process. Some of these responsibilities were being formalized and centralized for the first time, having previously been distributed throughout the Board at the Office and Division Director levels. The Director of this Office will continue to plan and initiate economic studies, analyses and surveys and prepare background material for, and a finished draft of, the Annual Report to the Congress.

The Board considers that the reorganization resulted in more clearly defined areas of responsibility and the consolidation of "like" functions under a single Director.

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